Internal Revenue
bulletin

Bulletin No. 2012-40
October 1, 2012

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. 9599, page 417.

Final regulations under section 1273 of the Code clarify the circumstances in which property is traded on an established market (that is, publicly traded) for purposes of determining the issue price of a debt instrument.

Rev. Proc. 2012–40, page 424.

This procedure provides domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Code for taxable years beginning after December 31, 2010.

EXCISE TAX

Notice 2012–57, page 424.

This notice was released to the media on August 31, 2012. This notice informs taxpayers that the IRS has granted an extension of time to electronically file Forms 2290 (*"Heavy Highway Vehicle Use Tax Return"*) that were due on August 31, 2012. The extension of time to file electronic returns was granted because the IRS Modernized eFile (MeF) system was unavailable from August 31, 2012, through September 4, 2012, for electronic filing of Form 2290. The time to file the Form 2290 and pay the associated tax has been extended from August 31, 2012, to September 7, 2012.

ADMINISTRATIVE

REG–138367–06, page 426.

Proposed regulations modify the standards governing written advice, clarify recent amendments to Circular 230, and update certain provisions as appropriate.

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

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Actions Relating to Decisions of the Tax Court

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

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

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

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

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

The Commissioner does NOT ACQUIESCE in the following decision:

International Business Machines Corp. v. United States, [1]
343 F.2d 914 (Ct. Cl. 1965),
cert. denied, 382 U.S. 1028 (1966)

[1] Nonacquiescence to the Court of Claims' decision that the Service was required to apply an adverse ruling prospectively because retroactive application would treat the taxpayer who requested the ruling differently from a taxpayer who received a favorable ruling on the same subject.

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

Section 1273.—Determination of Amount of Original Issue Discount

26 CFR 1.1273–1: Definition of OID.

T.D. 9599

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

Property Traded on an Established Market

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that apply to determine when property is traded on an established market (that is, publicly traded) for purposes of determining the issue price of a debt instrument. The regulations amend the current regulations to clarify the circumstances that cause property to be publicly traded. The regulations also amend the current regulations for reopenings of debt instruments, potentially abusive situations, and the definition of qualified stated interest. The regulations provide guidance to issuers and holders of debt instruments.

DATES: *Effective Date:* These regulations are effective on September 13, 2012.

Applicability Dates: For the applicability dates, see §§1.1273–1(c)(6)(ii), 1.1273–2(f)(10), 1.1274–3(b)(4)(ii), and 1.1275–2(k)(5).

FOR FURTHER INFORMATION CONTACT: William E. Blanchard at (202) 622–3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these regulations relating to the furnishing of information under §1.1273–2 to determine the issue price of a debt instrument was previously reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1353. The collection of information in these final regulations is in §1.1273–2(f)(9) and is an increase in the total annual burden in the current regulations under §1.1273–2. Under §1.1273–2(f)(9), the issuer of a debt instrument is required to make the fair market value of property (which can be stated as the issue price of the debt instrument) available to holders in a commercially reasonable fashion within 90 days of the date that the debt instruments are issued, including by electronic publication. The issuer's determinations are binding on all holders of the debt instrument unless the holder explicitly discloses that its determinations are different from the issuer's determinations on a timely filed Federal income tax return for the taxable year that includes the acquisition date of the debt instrument. The disclosure must include how the holder determined the value or issue price that it is using. This information is required by the IRS to ensure consistent treatment between the issuer and the holders or to alert the IRS when inconsistent positions are being taken by the issuer and one or more holders. This information will be used for audit and examination purposes. The likely respondents are businesses or other for-profit institutions.

Estimated total annual reporting burden is 10,000 hours.

Estimated average annual burden per respondent is .5 hours.

Estimated average burden per response is 5 minutes.

Estimated number of respondents is 20,000.

Estimated total frequency of responses is 20,000.

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

Background

The issue price of a debt instrument is determined under section 1273(b) of the Internal Revenue Code (Code) or, in the case of certain debt instruments issued for property, under section 1274. Section 1273(b)(3) generally provides that in the case of a debt instrument issued for property and part of an issue some or all of which is traded on an established securities market (often referred to as "publicly traded"), the issue price of the debt instrument is the fair market value of the debt instrument. Similarly, if a debt instrument is issued for stock or securities (or other property) that are publicly traded, the issue price of the debt instrument is the fair market value of the stock, securities, or other property. If a debt instrument issued for property is not publicly traded or is not issued for property that is publicly traded, the issue price of the debt instrument is usually determined under section 1274, which generally results in an issue price equal to the stated principal amount of the debt instrument if the debt instrument provides for adequate stated interest.

Section 1.1273–2 of the Income Tax Regulations (the "current regulations") contains the rules that generally apply to determine the issue price of a debt instrument that is publicly traded or is issued for publicly traded property and when property (including a debt instrument issued for property) is publicly traded. In general, under §1.1273–2(f) of the current regulations, property is traded on an established market (that is, publicly traded for purposes of section 1273(b)(3) and §1.1273–2) if the property is exchange listed property, market traded property, property appearing on a quotation medium, or readily quotable property in the 60-day period ending 30 days after the issue date of the debt instrument.

The issue price of a debt instrument has important income tax consequences. As

an initial matter, the difference between the issue price of a debt instrument and its stated redemption price at maturity measures whether there is any original issue discount (OID) associated with the instrument. A debt-for-debt exchange (including a significant modification of existing debt) in the context of a workout may result in a reduced issue price for the new debt, which generally would produce cancellation of indebtedness income for the issuer, a loss to the holder whose basis is greater than the issue price of the new debt, and OID that generally must be accounted for by both the issuer and the holder of the new debt. These consequences, exacerbated by the effects of the credit crisis on the debt markets in recent years, have focused attention on the definition of when property is traded on an established market for purposes of §1.1273–2(f).

A notice of proposed rulemaking (REG–131947–10, 2011–8 I.R.B. 521 [76 FR 1101]) (proposed regulations) was published in the **Federal Register** on January 7, 2011. No public hearing was requested or held. However, written comments responding to the notice of proposed rulemaking were received from the public. These comments were considered and are available for public inspection at *http://www.regulations.gov* or upon request. After consideration of the comments, the proposed regulations are adopted as amended by this Treasury decision. The comments and the revisions are discussed in this preamble.

Summary of Comments and Explanation of Provisions

The increased liquidity and transparency of the debt markets in recent years has largely eliminated concerns about reliable information on sales and pricing being unavailable. The proposed regulations acknowledge this fact by updating and streamlining the "publicly traded" standard under the current regulations to reflect current market practice. To the extent that objective pricing information exists, the proposed regulations use that information to determine issue price for purposes of section 1273.

Although the final regulations substantially follow the framework established in the proposed regulations, comments received on the proposed regulations prompted several changes. The final regulations dispense with the category of exchange listed property because the small amount of debt that is listed rarely actually trades over the exchange. Moreover, although stock, commodities, and similar property are commonly listed on and traded over a board or exchange, such property typically will be the subject of frequent sales or quotes and would be covered in a separate category of publicly traded property. A debt instrument that is issued for stock, commodities, or similar exchange traded property is therefore tested under the rule for property where there is a sales price or quote within the 31-day period ending 15 days after the issue date of the debt instrument. Eliminating the category of property listed on an exchange also eliminates the need for the *de minimis* trading exception in the proposed regulations, which was intended to exclude property that is listed on an exchange but trades in a negligible quantity.

In response to commenters, the final regulations also expand and clarify the $50 million exception for small debt issues in the proposed regulations. Participants in the debt trading markets indicated that liquidity begins to noticeably diminish when an issue falls below $100 million. The final regulations therefore expand the small debt issue exception from $50 million to $100 million, which creates an automatic exclusion for debt that is the least likely to be publicly traded. The final regulations also clarify that the exception applies based on the outstanding stated principal amount of the debt instruments in an issue when the determination is made.

The other significant change made in the final regulations is to require that issue price be reported consistently by issuers and holders. In response to comments, the final regulations provide that an issuer's determination as to whether property is traded on an established market and, if it is, the fair market value of the property generally is binding on the holders of the debt instrument. Information on pricing and recent sales generally is easily accessible by the issuer of a debt instrument, making the issuer the logical person to determine issue price. The final regulations also require the issuer to make the fair market value of the property (which can be stated as the issue price of the debt instrument) available to holders in a commercially reasonable fashion, which can be a posting to a web site or similar electronic publication, within 90 days of the date that the debt instruments are issued. If a holder makes a contrary determination that the property is or is not traded on an established market, or uses a fair market value that is different from the value determined by the issuer, the holder must file a statement with its income tax return that explicitly states that it is using a different determination, the reasons for the different determination and, if applicable, describes how fair market value was determined.

There also was a comment urging that the final regulations be accompanied by additional regulations, possibly under section 446(b), that would require a matching of the cancellation of debt income that often accompanies a debt-for-debt exchange (with the issue price of the new debt instrument determined under these rules) with the OID deductions that accrue subsequently on the new debt instrument. As an alternative, commenters suggested that the Treasury Department and IRS provide a special rule that treats the issue price of the new debt instrument in a debt-for-debt exchange as being equal to the lesser of the issue price determined under the principles of section 1274 and the adjusted issue price of the old debt instrument, whether or not the old debt instrument or the new debt instrument is publicly traded. The same commenters recommended that the suspension of the application of the applicable high yield discount obligation rules in section 163(e)(5) be extended, as they were in Notice 2010–11, 2010–4 I.R.B. 326, January 25, 2010, or that similar relief be provided for all debt instruments issued in an exchange that meets certain conditions. These suggestions were not adopted because they are outside the scope of these regulations.

The remaining comments relate to specific aspects of the proposed regulations. For example, one commenter recommended that the final regulations specify that property falls within the *de minimis* trading exception if no actual sales of the property occur during the 31-day period ending 15 days after the issue date. As previously noted, because the *de minimis* trading exception was not adopted in the final regulations and the existence of price quotations can be used to accurately determine the fair market value of a debt

instrument, this comment was not adopted in the final regulations.

Several comments pertain to the rules for sales and price quotations. One commenter recommended that the final regulations provide that a sales price or quote for property must provide a reasonable basis to determine fair market value for the property to be treated as publicly traded. Another commenter recommended that if an available actual sales price or quote is from a date different than the issue date and the taxpayer has a reasonable basis to conclude that the fair market value as of the issue date is different from such sales price or quote, the taxpayer may use reasonable methods to modify such price or quote to arrive at the fair market value as of the issue date. Commenters also recommended that the final regulations clarify that a price quote must be a *bona fide* price quote to a third party to buy and sell, must be available to the issuer or the holder who is determining the issue price of the debt instrument in question, and must exist independently of any inquiry the issuer or the holder makes in connection with the issue price determination. The final regulations rely on sales information and price quotations from brokers, dealers, and pricing services, which are widely available to market participants that trade debt instruments. Recent financial information, whether in the form of sales or price quotes, is the most reliable objective information available on fair market value, and such information is readily available to participants in the debt trading markets. The final regulations are therefore responsive to the concerns expressed by commenters. Moreover, as discussed earlier in the preamble, the final regulations require the issuer to disclose the fair market value of property to the holders, which will ensure that the issue price is available to holders in most situations.

In addressing the provision in the proposed regulations that permits taxpayers to use any reasonable method, consistently applied, to determine the fair market value when there is more than one sales price or price quotation, commenters requested that the final regulations describe various factors that taxpayers may consider in establishing fair market value. In response to this comment, the final regulations provide a non-exclusive list of factors a taxpayer may consider to establish fair market value. However, a method that may be reasonable in one situation may not be so in another situation. In addition, in response to another comment on this provision in the proposed regulations, the final regulations provide that a method will be regarded as consistently applied as long as it is consistently applied to the same or substantially similar facts to determine the fair market value.

One commenter recommended that the final regulations clarify that a sales price exists within the meaning of proposed §1.1273–2(f)(3)(i) only if the purchase and sale of the property occurs, and the sales price is reasonably available, during the testing period. The final regulations accept part of this suggestion by explicitly incorporating the 31-day time period in the description of when a sales price exists, but the suggestion that the sales price must be available in that same time period would be needlessly restrictive and is not adopted. The final regulations specifically provide that taxpayers are only required to search for executed sales for a reasonable period of time after the issue date (including a significant modification), but that time need not be within the 31 days surrounding the issue date. Here, too, the addition of the issuer-holder consistency rule described earlier in the preamble will considerably alleviate the burden of determining when a sale has occurred because the issuer is usually in the best position to know when its debt has been sold or modified.

In response to a comment, the final regulations add a second anti-abuse rule providing that if there is any sale or price quote a principal purpose of which is to cause the property to be traded on an established market or to materially misrepresent the value of property for federal income tax purposes, then the sale or price quote is disregarded.

Finally, a commenter recommended that the effective date of the final regulations be modified to provide that the new rules do not apply to any debt instrument issued or exchanged pursuant to a written binding agreement entered into by the taxpayer before the date that the final regulations are published in the **Federal Register**. The final regulations do not adopt this comment. However, to minimize their effect on pending transactions, the final regulations under §1.1273–2(f) apply only to debt instruments issued on or after 60 days after the publication date of the final regulations.

Other Provisions

The proposed regulations expanded the definition of a qualified reopening under §1.1275–2(k) to debt instruments that are issued for cash to unrelated persons, provided that the other requirements of the regulations are satisfied. Commenters requested that the qualified reopening rules in §1.1275–2(k) be further liberalized. In response to these comments, the final regulations expand the definition of a qualified reopening to include an issuance that satisfies a 100 percent yield test for a reopening after six months. This change is consistent with the intent of the reopening rules, which prevent taxpayers from converting OID into market discount. In response to comments, the final regulations also make slight revisions to the rules used to determine the testing date for a qualified reopening.

Comments also were received on the proposed amendment to the regulations under section 1274 that address potentially abusive situations. One commenter suggested that the change to §1.1274–3 be deferred and considered as part of a larger project addressing distorted gains from modifications, or, alternatively, that the proposed change be limited so that the recent sale rule continues to apply to a debt modification if all sales that are part of the recent sales transaction involve, in the aggregate, a large portion of the modified debt (for example, more than 50 percent by principal amount). Another commenter requested that the final regulations not apply if either a recent sale occurs or a binding contract providing for the recent sale is entered into prior to publication because investors may commit to buy pools of discount debt in reliance on existing law. Potential distortions created by distressed debt situations are the subject of a separate guidance project. In the meantime, the Treasury Department and the IRS believe that the proposed regulations reach the correct result in determining issue price under section 1274, and the final regulations do not adopt these suggestions. However, to minimize their effect on pending transactions, the final regulations under §1.1274–3(b)(4) apply

only to a debt instrument issued on or after 60 days after the publication date of the final regulations.

Effective/Applicability Date

The regulations generally apply to a debt instrument issued on or after November 13, 2012.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. 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 the collection of information imposed on a taxpayer generally only applies if the outstanding stated principal amount of the debt is more than $100 million, which is anticipated to affect only a small number of small entities. Moreover, any economic impact is expected to be minimal because it should take a taxpayer no more than one-half hour to satisfy the information-sharing requirement in these regulations. 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 proposed regulations preceding these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

These regulations were drafted by personnel in the Office of Associate Chief Counsel (Financial Institutions and Products) and the Treasury Department.

* * * * *

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 1.1271–0 is amended as follows:

1. The introductory text for paragraph (b) is revised.

2. Adding the entry for §1.1273–1(c)(6).

3. Revising the entries for §1.1273–2(f)(2) through (7).

4. Adding the entries for §1.1273–2(f)(8) through (10).

5. Adding the entry for §1.1274–3(b)(4).

6. Revising the entry for §1.1275–2(k)(5).

The revisions and additions read as follows:

§1.1271–0 Original issue discount; effective date; table of contents.

* * * * *

(b) *Table of contents.* This section lists captioned paragraphs contained in §§1.1271–1 through 1.1275–7.

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§1.1273–1 Definition of OID.

* * * * *

(c) * * *

(6) Business day convention.

* * * * *

§1.1273–2 Determination of issue price and issue date.

* * * * *

(f) * * *

(2) Sales price.

(3) Firm quote.

(4) Indicative quote.

(5) Presumption that price or quote is equal to fair market value.

(6) Exception for small debt issues.

(7) Anti-abuse rules.

(8) Convertible debt instruments.

(9) Issuer-holder consistency requirement.

(10) Effective/applicability dates.

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§1.1274–3 Potentially abusive situations defined.

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(b) * * *

(4) Debt-for-debt exchange.

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§1.1275–2 Special rules relating to debt instruments.

* * * * *

(k) * * *

(5) Effective/applicability dates.

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Par. 3. Section 1.1273–1 is amended by adding a new paragraph (c)(6) to read as follows:

§1.1273–1 Definition of OID.

* * * * *

(c) * * *

(6) *Business day convention*—(i) *Rule.* For purposes of this paragraph (c), if a scheduled payment date for stated interest falls on a Saturday, Sunday, or Federal holiday (within the meaning of 5 U.S.C. 6103) but, under the terms of the debt instrument, the stated interest is payable on the first business day that immediately follows the scheduled payment date, the stated interest is treated as payable on the scheduled payment date, provided no additional interest is payable as a result of the deferral.

(ii) *Effective/applicability date.* Paragraph (c)(6)(i) of this section applies to a debt instrument issued on or after September 13, 2012. A taxpayer, however, may rely on paragraph (c)(6)(i) of this section for a debt instrument issued before that date.

* * * * *

Par. 4. Section 1.1273–2 is amended by adding a sentence at the end of paragraphs (b)(1) and (c)(1) and revising paragraph (f) to read as follows:

§1.1273–2 Determination of issue price and issue date.

* * * * *

(b) * * *

(1) * * * See paragraph (f) of this section for rules to determine the fair market value of a debt instrument for purposes of this section.

* * * * *

(c) * * *

(1) * * * See paragraph (f) of this section for rules to determine the fair market value of property for purposes of this section.

* * * * *

(f) *Traded on an established market (publicly traded)*—(1) *In general*. Except as provided in paragraph (f)(6) of this section, property (including a debt instrument described in paragraph (b)(1) of this section) is traded on an established market for purposes of this section if, at any time during the 31-day period ending 15 days after the issue date—

(i) There is a sales price for the property as described in paragraph (f)(2) of this section;

(ii) There are one or more firm quotes for the property as described in paragraph (f)(3) of this section; or

(iii) There are one or more indicative quotes for the property as described in paragraph (f)(4) of this section.

(2) *Sales price*—(i) *In general*. A sales price exists if the price for an executed purchase or sale of the property within the 31-day period described in paragraph (f)(1) of this section is reasonably available within a reasonable period of time after the sale.

(ii) *Pricing information for a debt instrument*. For purposes of paragraph (f)(2)(i) of this section, the price of a debt instrument is considered reasonably available if the sales price (or information sufficient to calculate the sales price) appears in a medium that is made available to issuers of debt instruments, persons that regularly purchase or sell debt instruments (including a price provided only to certain customers or to subscribers), or persons that broker purchases or sales of debt instruments.

(3) *Firm quote*. A firm quote is considered to exist when a price quote is available from at least one broker, dealer, or pricing service (including a price provided only to certain customers or to subscribers) for property and the quoted price is substantially the same as the price for which the person receiving the quoted price could purchase or sell the property. A price quote is considered to be available whether the quote is initiated by a person providing the quote or provided at the request of the person receiving the quote. The identity of the person providing the quote must be reasonably ascertainable for a quote to be considered a firm quote for purposes of this paragraph (f)(3). A quote will be considered a firm quote if the quote is designated as a firm quote by the person providing the quote or if market participants typically purchase or sell, as the case may be, at the quoted price, even if the party providing the quote is not legally obligated to purchase or sell at that price.

(4) *Indicative quote*. An indicative quote is considered to exist when a price quote is available from at least one broker, dealer, or pricing service (including a price provided only to certain customers or to subscribers) for property and the price quote is not a firm quote described in paragraph (f)(3) of this section.

(5) *Presumption that price or quote is equal to fair market value*—(i) *In general*. For purposes of this section, the fair market value of property will be presumed to be equal to its sales price or quoted price determined under paragraphs (f)(2) through (f)(4) of this section. If there is more than one sales price under paragraph (f)(2) of this section, more than one quoted price under paragraph (f)(3) or (f)(4) of this section, or both one or more sales prices under paragraph (f)(2) of this section and quoted prices under paragraph (f)(3) or (f)(4) of this section, a taxpayer may use any reasonable method, consistently applied to the same or substantially similar facts, to determine the fair market value. For example, to determine the fair market value under a reasonable method, a taxpayer may consider factors such as (but not necessarily limited to) the timing of each relevant sale or quote in relation to the issue date; whether the price is derived from a sale, a firm quote, or an indicative quote; the size of each relevant sale or quote; or whether the sales price or quote corresponds to pricing information provided by an independent bond or loan pricing service.

(ii) *Special rule for property for which there is only an indicative quote*. If property is described only in paragraph (f)(4) of this section, and the taxpayer determines that the quote (or an average of the quotes) materially misrepresents the fair market value of the property, the taxpayer can use any method that provides a reasonable basis to determine the fair market value of the property. A taxpayer must establish that the method chosen more accurately reflects the value of the property than the quote or quotes for the property to use the method provided in this paragraph (f)(5)(ii). For an equity or debt instrument, a volume discount or control premium will not be considered to create a material misrepresentation of value for purposes of this paragraph (f)(5)(ii).

(6) *Exception for small debt issues*. Notwithstanding any other provision in paragraph (f) of this section, a debt instrument will not be treated as traded on an established market if at the time the determination is made the outstanding stated principal amount of the issue that includes the debt instrument does not exceed US$100 million (or, for a debt instrument denominated in a currency other than the U.S. dollar, the equivalent amount in the currency in which the debt instrument is denominated).

(7) *Anti-abuse rules*—(i) *Effect of certain temporary restrictions on trading*. If there is any temporary restriction on trading a purpose of which is to avoid the characterization of the property as one that is traded on an established market for Federal income tax purposes, then the property is treated as traded on an established market. For purposes of the preceding sentence, a temporary restriction on trading need not be imposed by the issuer.

(ii) *Artificial pricing information*. If a principal purpose for the existence of any sale or price quotation is to cause the property to be traded on an established market or to materially misrepresent the value of property, that sale or price quotation is disregarded.

(8) *Convertible debt instruments*. A debt instrument is not treated as traded on an established market solely because the debt instrument is convertible into property that is so traded.

(9) *Issuer-holder consistency requirement*—(i) *General rule*. For purposes of this section, an issuer must determine whether property is traded on an established market and, if so, the fair market value of the property. An issuer is required to exercise reasonable diligence to determine whether purchases or sales have taken place, the quantity of purchases and sales, the price at which purchases or sales occurred, the existence of firm or indicative quotes, and any other relevant

information using the rules provided in paragraph (f) of this section to determine the fair market value of the property. If an issuer determines that property is traded on an established market, the issuer is required to make that determination as well as the fair market value of the property (which can be stated as the issue price of the debt instrument) available to holders in a commercially reasonable fashion, including by electronic publication, within 90 days of the date that the debt instrument is issued. Each determination by an issuer is binding on a holder of the debt instrument unless the holder explicitly discloses that its determination is different from the issuer's determination (for example, the holder determines a different fair market value for the property or determines that the property is not traded on an established market). A holder must describe in the disclosure the reasons for its different determination and, if applicable, how the holder determined the fair market value. A holder's disclosure must be filed on a timely filed Federal income tax return for the taxable year that includes the acquisition date of the debt instrument. If an issuer for any reason does not make the fair market value or issue price of a debt instrument reasonably available to a holder, the holder must determine the fair market value of the property and issue price of the debt instrument using the rules provided in paragraph (f) of this section.

(ii) *Co-obligors*. If a debt instrument has more than one obligor, the obligors must designate one obligor (issuer) to determine whether property is traded on an established market and, if so, the fair market value of the property and issue price of the debt instrument and make the price available to holders using the rules provided in paragraph (f)(9)(i) of this section.

(10) *Effective/applicability dates*—(i) This paragraph (f) applies to a debt instrument issued on or after November 13, 2012.

(ii) For rules applying to a debt instrument issued before November 13, 2012, see paragraph (f) of this section as contained in 26 CFR part 1, revised April 1, 2011.

* * * * *

Par. 5. Section 1.1274–3 is amended by adding a new paragraph (b)(4) to read as follows:

§1.1274–3 Potentially abusive situations defined.

* * * * *

(b) * * *

(4) *Debt-for-debt exchange*—(i) *Rule*. A debt instrument issued in a debt-for-debt exchange, including a deemed exchange under §1.1001–3, will not be treated as the subject of a recent sales transaction for purposes of section 1274(b)(3)(B)(ii)(I) even if the debt instrument exchanged for the newly issued debt instrument was recently acquired prior to the exchange. Therefore, the issue price of the debt instrument will not be determined under section 1274(b)(3). However, if the debt instrument or the property for which the debt instrument is issued is publicly traded within the meaning of §1.1273–2(f), the rules of §1.1273–2 will apply to determine the issue price of the debt instrument.

(ii) *Effective/applicability date*. Paragraph (b)(4)(i) of this section applies to a debt instrument issued on or after November 13, 2012.

* * * * *

Par. 6. Section 1.1275–2 is amended by:

1. Adding a sentence at the end of paragraph (d)(2)(ii)(C).

2. Revising the first sentence of paragraph (k)(3)(i).

3. Revising paragraphs (k)(3)(ii)(A), (k)(3)(iii)(A) and (k)(5).

4. Redesignating paragraph (k)(3)(iv) as newly designated paragraph (k)(3)(vi).

5. Adding new paragraphs (k)(3)(iv) and (k)(3)(v).

The revisions and additions read as follows:

§1.1275–2 Special rules relating to debt instruments.

* * * * *

(d) * * *

(2) * * *

(ii) * * *

(C) * * * For a reopening of Treasury securities that occurs on or after September 13, 2012, a qualified reopening also is a reopening of Treasury securities that is described in paragraph (k)(3)(v) of this section.

* * * * *

(k) * * *

(3) * * *

(i) * * *A qualified reopening is a reopening of original debt instruments that is described in paragraph (k)(3)(ii), (k)(3)(iii), (k)(3)(iv), or (k)(3)(v) of this section. * * *

(ii) * * *

(A) The original debt instruments are publicly traded (within the meaning of §1.1273–2(f)) as of the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date);

* * * * *

(iii) * * *

(A) The original debt instruments are publicly traded (within the meaning of §1.1273–2(f)) as of the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date); and

* * * * *

(iv) *Non-publicly traded debt issued for cash*. A reopening is described in this paragraph (k)(3)(iv) if the additional debt instruments are issued for cash to persons unrelated to the issuer (as determined under section 267(b) or 707(b)) for an arm's length price and either the requirements in paragraphs (k)(3)(ii)(B) and (k)(3)(ii)(C) of this section for a reopening within six months are satisfied or the requirements in paragraph (k)(3)(iii)(B) of this section for a reopening with *de minimis* OID are satisfied. For purposes of paragraph (k)(3)(ii)(C) of this section, the yield test is satisfied if, on the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date), the yield of the additional debt instruments (based on their cash purchase price) is not more than 110 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate).

(v) *100 Percent yield test for reopening after six months*. A reopening is described in this paragraph (k)(3)(v) if the additional debt instruments are issued more than six months after the issue date of the original debt instruments and either the requirements in paragraphs (k)(3)(ii)(A) and (k)(3)(ii)(C) of this section are satisfied or the additional debt instruments are issued for cash to persons unrelated to the

issuer (as determined under section 267(b) or 707(b)) for an arm's length price and the requirements in paragraph (k)(3)(ii)(C) of this section are satisfied. For purposes of the preceding sentence, the yield test in paragraph (k)(3)(ii)(C) of this section is satisfied if, on the date on which the price of the additional debt instruments is established (or, if earlier, the announcement date), the yield of the additional debt instruments (based on their fair market value or cash purchase price, whichever is applicable) is not more than 100 percent of the yield of the original debt instruments on their issue date (or, if the original debt instruments were issued with no more than a *de minimis* amount of OID, the coupon rate).

* * * * *

(5) *Effective/applicability dates*—(i) Except as provided in paragraph (k)(5)(ii) of this section, this paragraph (k) applies to debt instruments that are part of a reopening if the reopening date is on or after March 13, 2001.

(ii) Paragraphs (k)(3)(ii)(A), (k)(3)(iii)(A), (k)(3)(iv) and (k)(3)(v) of this section apply to debt instruments that are part of a reopening if the reopening date is on or after September 13, 2012.

Par. 7. Section 1.1275–4 is amended by revising the first sentence in paragraph (b)(9)(i)(E) to read as follows:

§1.1275–4 Contingent payment debt instruments.

* * * * *

(b) * * *

(9) * * *

(i) * * *

(E) * * * If the debt instrument is exchange listed property (within the meaning of §1.1273–2(f)(2) as contained in 26 CFR part 1, revised April 1, 2011), it is reasonable for the holder to allocate any difference between the holder's basis and the adjusted issue price of the debt instrument *pro-rata* to daily portions of interest (as determined under paragraph (b)(3)(iii) of this section) over the remaining term of the debt instrument.

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where Identified and described	Current OMB Control No.
* * * * *	
1.1273–2(f)(9)	1545–1353
* * * * *	

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

Approved August 17, 2012.

(Filed by the Office of the Federal Register on September 12, 2012, 8:45 a.m., and published in the issue of the Federal Register for September 13, 2012, 77 F.R. 56533)

Part III. Administrative, Procedural, and Miscellaneous

Certain Filing Changes for Heavy Highway Vehicle Use Tax Return

Notice 2012–57

This notice notifies taxpayers that the IRS Modernized eFile (MeF) system will not be available from August 31, 2012, through September 4, 2012, for electronic filing of Form 2290, *Heavy Highway Vehicle Use Tax Return*. In addition, this notice describes extended filing and payment deadlines available to taxpayers affected by this suspension period.

Suspension of IRS MeF System for 2290 Filers

Section 4481 imposes a tax on the use in any taxable period of a highway motor vehicle with a taxable gross weight of 55,000 pounds or more. Generally, a "taxable period" is the year that begins on July 1 and ends on the following June 30. Section 41.6011(a)–1 of the Highway Use Tax Regulations requires each person that is liable for the tax imposed by section 4481 to file a return for each taxable period on Form 2290, *Heavy Highway Vehicle Use Tax Return*. Section 41.6151(a)-(1)T provides that the tax must be paid at the time prescribed in § 41.6071(a)–1 for filing the return and at the place prescribed in §41.6091–1 for filing the return. Under § 41.6071(a)–1(a), Form 2290 generally must be filed by the last day of the month following the month in which a person becomes liable for tax. For the taxable period that begins on July 1, 2012, and ends on June 30, 2013, taxpayers subject to the tax under section 4481 must file Form 2290 by August 31, 2012, for vehicles on the road during July 2012. For vehicles first used after July 2012, the filing deadline is the last day of the month following the month of first use.

To facilitate systems and programming changes, the IRS is suspending the availability of its MeF system for filing Form 2290 from August 31, 2012, through September 4, 2012 (the suspension period).

Extended Filing Date for Eligible Affected Taxpayers

To minimize the impact on affected taxpayers, the IRS is granting an extension of time under section 6081(a) to electronically file Form 2290 to affected taxpayers whose due date for the return is August 31, 2012. The extended due date is now September 7, 2012. Only taxpayers that electronically file Form 2290 with a due date of August 31, 2012, are considered "affected taxpayers" for purposes of this notice. Taxpayers filing a paper Form 2290 must continue to file by the original due date of August 31, 2012.

Extension of Time for Paying Tax

The IRS is also granting an extension of time under section 6161(a)(1) to pay the tax imposed by section 4481. Because this tax is due when a taxpayer files its Form 2290, affected taxpayers that take advantage of the September 7, 2012, electronic filing deadline and pay the tax owed under section 4481 by that date will be considered to have timely paid such tax. Taxpayers filing a paper Form 2290 must continue to pay their tax by August 31, 2012.

Penalties

If an affected taxpayer e-files Form 2290 after September 7, 2012, and receives a system-generated notice from the IRS that imposes a penalty, the taxpayer may call the telephone number on that notice with any questions about the computation of the penalty.

Effective Date

This notice is effective as of August 31, 2012.

Contact Information

For further information regarding this notice, please contact Ms. Natalie Payne of the Office of Associate Chief Counsel (Passthroughs and Special Industries) at (202) 622–3130 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of tax liability.
(Also: §842(b).)

Rev. Proc. 2012–40

SECTION 1. PURPOSE

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 2010. Instructions are provided for computing foreign insurance companies' liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2010. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies' liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2009, see Rev. Proc. 2011–45, 2011–39 I.R.B. 449.

SECTION 2. CHANGES

DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2011. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 2010, the relevant domestic asset/liability percentages are:

166.1 percent for foreign life insurance companies, and

189.6 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2011. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance

companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 2010, the relevant domestic investment yields are:

3.2 percent for foreign life insurance companies, and

3.2 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2011. The section 842(b) percentages to be used for the 2011 tax year are based on tax return data following the same methodology used for the 2010 year.

SECTION 3. APPLICATION—ESTIMATED TAXES

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 2010, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2011–45 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2010.

SECTION 5. DRAFTING INFORMATION

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

Part IV. Items of General Interest

Withdrawal of Notice of Proposed Rulemaking; Notice of Proposed Rulemaking and Notice of Public Hearing

Regulations Governing Practice Before the Internal Revenue Service

REG–138367–06

AGENCY: Office of the Secretary, Treasury.

ACTION: Withdrawal of notice of proposed rulemaking; notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document proposes modifications of the regulations governing practice before the Internal Revenue Service (IRS). These proposed regulations affect individuals who practice before the IRS. These proposed regulations modify the standards governing written advice and update certain provisions as appropriate. This document also provides notice of a public hearing on the proposed regulations and withdraws the notice of proposed rulemaking published on December 20, 2004, setting forth standards for State or local bond opinions.

DATES: Comments must be received by November 16, 2012. Outlines of topics to be discussed at the public hearing scheduled for December 7, 2012 at 10 a.m., in the Auditorium of the Internal Revenue Service building at 1111 Constitution Avenue, NW, Washington, DC 20224, must be received by November 16, 2012.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–138367–06), room 5205, Internal Revenue Service, P.O. 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–138367–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically via the Federal eRulemaking Portal at *www.regulations.gov* (indicate IRS and REG–138367–06). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning issues for comment, Matthew D. Lucey at (202) 622–4940; concerning submissions of comments the public hearing, or to be placed on the building access list to attend the hearing, Oluwafunmilayo Taylor at (202) 622–7180; (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 330 of title 31 of the United States Code authorizes the Secretary of the Treasury to regulate practice before the Treasury Department (Treasury). The Secretary has published regulations governing practice before the IRS in 31 CFR part 10 and reprinted the regulations as Treasury Department Circular No. 230 (Circular 230).

Treasury and the IRS have consistently maintained that tax practitioners must meet minimum standards of conduct with respect to written tax advice, and those who do not should be subject to disciplinary action, including suspension or disbarment. In accordance with these principles, the regulations have been amended from time to time to address issues relating to tax opinions and written tax advice.

In February 1984, the regulations were amended to provide standards for providing opinions used in tax shelter offerings in accordance with American Bar Association Formal Opinion 346 (49 FR 6719). The 1984 amendments required a practitioner who renders a tax shelter opinion to exercise responsibility with respect to the accuracy of the relevant facts; apply the law to the particular facts of the tax shelter offering; ascertain that all material Federal tax issues have been considered; when possible, provide an opinion as to the likely outcome on the merits of each material tax issue; provide an evaluation of the extent to which the material tax benefits in the aggregate will be realized; and assure that the nature and extent of the tax shelter opinion is described correctly in the offering materials.

In January 2001, Treasury and the IRS proposed additional amendments regarding tax shelter opinions. See 66 FR 3276. The 2001 notice of proposed rulemaking addressed both general matters pertaining to practice before the IRS and matters pertaining specifically to tax shelter opinions, but the portion of these regulations regarding tax shelter opinions was not finalized. Rather, on December 30, 2003, Treasury and the IRS published in the **Federal Register** (68 FR 75186) (the 2003 proposed regulations) a second notice of proposed rulemaking to set forth best practices for tax advisors and to modify the standards for certain tax shelter opinions. Subsequently, Congress amended section 330 of title 31 to clarify that the Secretary may impose standards for written advice relating to a matter that is identified as having a potential for tax avoidance or evasion (American Jobs Creation Act of 2004, Public Law 108–357, 118 Stat. 1418).

In December 2004, Treasury and the IRS finalized the 2003 proposed regulations by publishing final regulations (T.D. 9165, 2005–1 C.B. 357) in the **Federal Register** (69 FR 75839) setting forth best practices for tax advisors and providing standards for covered opinions and other written advice. Treasury and the IRS simultaneously issued a notice of proposed rulemaking (REG–159824–04, 2005–1 C.B. 372) in the **Federal Register** (69 FR 75887) proposing standards for practice before the IRS relating to State or local bond opinions. In May 2005, Treasury and the IRS published revisions to the final regulations (T.D. 9201, 2005–1 C.B. 1153) in the **Federal Register** (70 FR 28824) to clarify the standards for covered opinions. In June 2005, Treasury and the IRS published Notice 2005–47, 2005–1 C.B. 1373, providing interim guidance and information concerning State or local bond opinions. While not a complete list of revisions to Circular 230, the preceding history demonstrates Treasury and the IRS' commitment to maintaining minimum standards for written advice that foster an ethical environment for practitioners and taxpayers.

As explained later in the Explanation of Provisions section of this preamble, these proposed regulations amend Circular 230 by eliminating the complex rules governing covered opinions in current §10.35. In addition, these proposed regulations expand the requirements for written advice under §10.37 and withdraw the proposed amendments to §10.39 of the regulations governing requirements for State or local bond opinions. These proposed regulations also broaden the scope of the procedures to ensure compliance under §10.36 by requiring that a practitioner with principal authority for overseeing a firm's Federal tax practice take reasonable steps to ensure the firm has adequate procedures in place for purposes of complying with Circular 230. These proposed regulations clarify that practitioners must exercise competence when engaged in practice before the IRS and that the prohibition on a practitioner endorsing or otherwise negotiating any check issued to a taxpayer in respect of a Federal tax liability applies to government payments made by any means, electronic or otherwise. These proposed regulations expand the categories of violations subject to the expedited proceedings in §10.82 to include failures to comply with a practitioner's personal tax filing obligations that demonstrate a pattern of willful disreputable conduct. The proposed regulations also clarify the Office of Professional Responsibility's scope of responsibility.

Explanation of Provisions

Public awareness of the standards for written tax advice and the accountability of practitioners offering tax advice have increased since Treasury and the IRS published final regulations on covered opinions. This increased awareness and accountability is having a positive effect on our Federal tax system. Years of practical experience, however, have shown that the covered opinion rules in current §10.35 have produced some unintended consequences and should be reconsidered.

Reconsideration of the covered opinion rules is appropriate in light of continued practitioner dissatisfaction due to the difficulty and cost of compliance with the rules. Practitioners have consistently voiced their concern over the current rules since their promulgation in 2004. See the docket for IRS REG–138367–06 at *www.regulations.gov*. Practitioners overwhelmingly conclude that the rules are overbroad, difficult to apply, and do not necessarily produce higher quality tax advice. Many practitioners have stated that the rules unduly interfere with their client relationships and are not an ethical standard that everyone, including clients, can comprehend easily. Some practitioners have also opined that these rules may reduce, rather than enhance, tax compliance due to the perception that a covered opinion takes more time to produce and is more expensive for the client than other tax advice. In this same regard, it has been suggested that the rules increase the likelihood that practitioners will provide oral advice to their clients when written advice is more appropriate because current §10.35 does not govern oral advice.

Another concern that the government has heard from practitioners relates to the unrestrained use of disclaimers on nearly every practitioner communication regardless of whether the communication contains tax advice. Practitioners have stated that this practice discourages compliance with the ethical requirements because some practitioners have concluded that, if they include a disclaimer, they are free to disregard the standards in current §10.35 regarding written tax advice. The disclaimers also lead to confusion for clients because clients often do not understand why the disclaimer is present and its consequences. In addition, practitioners have complained that the disclaimer's widespread overuse causes clients to ignore the disclaimers altogether, and may render their use in some circumstances irrelevant.

Although practitioners have informed us that they support sensible regulation of written tax advice, they have expressed little support for the rules in their current form and we have received numerous requests to revise the rules. After years of experience with these rules, the government and practitioners agree that the covered opinion rules are often burdensome and provide only minimal taxpayer protection. Overall, the benefit is insufficient to justify the additional costs associated with practitioner compliance with the covered opinion rules. After careful consideration, including consideration of the public's experience with and comments on these rules, Treasury and the IRS have concluded that the written advice standards should be revised.

The proposed regulations will streamline the existing rules for written tax advice by removing current §10.35 and applying one standard for all written tax advice under proposed §10.37. Proposed §10.37 provides that the practitioner must base all written advice on reasonable factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts that the practitioner knows or should know. The proposed removal of §10.35 will eliminate the requirement that practitioners fully describe the relevant facts (including the factual and legal assumptions relied upon) and the application of the law to the facts in the written advice itself, and the use of Circular 230 disclaimers in documents and transmissions, including e-mails.

Other provisions, §§10.31, 10.36, and 10.82, are also being updated at this time to reflect the current practice environment. In addition, a general competence standard is being proposed in new §10.35. The proposed regulations also clarify that the Office of Professional Responsibility has exclusive responsibility for matters related to practitioner discipline, including disciplinary proceedings and sanctions.

The scope of these regulations is limited to practice before the IRS. These regulations do not alter or supplant other ethical standards applicable to practitioners.

1. *Amendments Regarding Rules Governing Written Advice*

A. *Elimination of Covered Opinion Rules in §10.35*

Current §§10.35 and 10.37 provide comprehensive rules with respect to written tax advice. Specifically, current §10.35 provides detailed rules for tax opinions that constitute "covered opinions" under Circular 230. Covered opinions include written advice concerning: (1) a listed transaction; (2) a transaction with the principal purpose of tax avoidance or evasion; or (3) a transaction with a significant purpose of tax avoidance or evasion, if the advice is a reliance opinion, marketed opinion, subject to conditions of confidentiality, or subject to a contractual protection.

The definitions of the various types of covered opinions under Circular 230 require considerable effort on behalf of practitioners to determine whether the advice rendered in a particular circumstance is subject to the covered opinion rules in current §10.35. Because of the effort involved, many practitioners attempt to exempt the advice from the covered opinion rules by making a prominent disclosure or disclaimer stating that the opinion cannot be relied upon for penalty protection, as permitted by Circular 230.

Circular 230 also requires that practitioners comply with the extensive requirements set forth in §10.35 when providing written advice that constitutes a covered opinion. Many of the standards in current §10.35 track principles a competent practitioner uses when considering and rendering any advice, although these standards may be more rigid and cumbersome in application than generally applicable ethical standards. For example, current §10.35 requires the practitioner to include in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts. This mechanical requirement of automatic inclusion of information will sometimes lead to awkward or unnecessary, highly technical discussions in the opinion that may hinder the practitioner's ability to provide quality tax advice. Further, the inclusion of this particular detail almost always burdens the practitioner and the client with significant increased costs, without necessarily increasing the quality of the tax advice that the client receives.

Significant progress has been made in combating abusive tax shelters and schemes, and preventing unscrupulous individuals from promoting those arrangements. In recent years, heightened awareness of the ethical standards governing tax advice contributed to this improved state and has benefited practitioners, taxpayers, and the government. At the same time, there is no direct evidence to suggest that the overly-technical and detailed requirements of current §10.35 were responsible for, or particularly effective at, curtailing the behavior of individuals attempting to profit from promoting frivolous transactions or transactions without a reasonable basis.

For these reasons, the proposed regulations eliminate the covered opinion rules in §10.35 and instead subject all written tax advice to streamlined standards under proposed §10.37, as described later in this preamble. The proposed regulations also remove references to current §10.35 in §§10.3, 10.22, and 10.52. The burden reduction that should result from the proposed regulations is consistent with the President's directive in Executive Order 13563 to remove or modify regulations that are outmoded, ineffective, insufficient, or too burdensome.

The elimination of the covered opinion rules in this notice of proposed rulemaking would, at a minimum, save tax practitioners $5,333,200. This burden reduction comes from the elimination of the provisions requiring practitioners to make certain disclosures in the covered opinion.

This number does not include a number of other significant savings to both tax practitioners and taxpayers relating to the cost of obtaining a covered opinion under the current rules that would occur as a result of the proposed regulations. Practitioners spend many hours each year determining whether they need to prepare a covered opinion for a client or if the advice falls into one of the exceptions. This requires significant time to, among other things, research and review the complicated covered opinion rules and discuss the issue with other practitioners in the firm to determine the right course of action. If the practitioner decides, after undertaking these activities, that a covered opinion is necessary, the practitioner must discuss the covered opinion rules with the client, including how the rules affect the scope of the work that the client has asked the practitioner to perform, because the client will incur significant extra costs to obtain the written advice the client requested. These significant extra costs can, in some cases, tip the scales against obtaining written advice.

B. *Revision of Requirements for Written Advice*

Treasury and the IRS continue to be aware of the risk associated with practitioners providing and marketing written tax opinions. Proposed §10.37, therefore, replaces the covered opinion rules with basic principles to which all practitioners must adhere when rendering written advice. The proposed provisions also complement the best practices of §10.33 and the due diligence requirements in §10.22. Specifically, the proposed regulations revise §10.37 to state affirmatively the standards to which a practitioner must adhere when providing written advice on a Federal tax matter. Proposed §10.37 requires, among other things, that the practitioner base all written advice on reasonable factual and legal assumptions, exercise reasonable reliance, and consider all relevant facts that the practitioner knows or should know. A practitioner must also use reasonable efforts to identify and ascertain the facts relevant to written advice on a Federal tax matter under the proposed regulations.

Consistent with current §10.37, the proposed regulations provide that a practitioner must not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that an issue will not be raised on audit. Proposed §10.37 eliminates the provision in the current regulations that prohibits a practitioner from taking into account the possibility that an issue will be resolved through settlement if raised when giving written advice evaluating a Federal tax matter. Treasury and IRS conclude that the current rule may unduly restrict the ability of a practitioner to provide comprehensive written advice because the existence or nonexistence of legitimate hazards that may make settlement more or less likely may be a material issue for which the practitioner has an obligation to inform the client.

Under proposed §10.37(c)(2), the IRS will continue to apply a heightened standard of review to determine whether a practitioner has satisfied the written advice standards when the practitioner knows or has reason to know that the written advice will be used in promoting, marketing, or recommending an investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code.

Proposed §10.37(b) also provides that a practitioner may rely on the advice of another practitioner only if the reliance on that advice is reasonable and in good faith considering the facts and circumstances. Specifically, proposed §10.37(b) provides that reliance is not reasonable when the

practitioner knows or should know that the opinion of the other practitioner should not be relied on, the other practitioner is not competent to provide the advice, or the other practitioner has a conflict of interest. These proposed reliance provisions incorporate reliance concepts from current §§10.22 and 10.35(d).

Proposed §10.37, unlike current §10.35, does not require that the practitioner describe in the written advice the relevant facts (including assumptions and representations), the application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts. Rather, the scope of the engagement and the type and specificity of the advice sought by the client, in addition to all other appropriate facts and circumstances, are factors in determining the extent that the relevant facts, application of the law to those facts, and the practitioner's conclusion with respect to the law and the facts must be set forth in the written advice. Also, under proposed §10.37, unlike current §10.35, the practitioner may consider these factors in determining the scope of the written advice. Further, the determination of whether a practitioner has failed to comply with the requirements of proposed §10.37 will be based on all facts and circumstances, not on whether each requirement is addressed in the written advice.

As discussed earlier in this preamble, many practitioners currently use a Circular 230 disclaimer at the conclusion of every e-mail or other writing as a measure to remove the advice from the covered opinion rules in §10.35. In many instances, these disclaimers are frequently inserted without regard to whether the disclaimer is necessary or appropriate. These types of disclaimers are routinely inserted in any written transmission, including writings that do not contain any tax advice. The proposed removal of current §10.35 eliminates the detailed provisions concerning covered opinions and disclosures in written opinions. Because proposed §10.37 does not include the disclosure provisions in the current covered opinion rules, Treasury and the IRS expect that these amendments, if adopted, will eliminate the use of a Circular 230 disclaimer in e-mail and other writings.

Overall, Treasury and the IRS have determined that the proposed regulations regarding written advice strike an appropriate balance between allowing practitioners flexibility in providing written advice and at the same time maintaining standards that require the practitioner to act ethically and competently. Treasury and the IRS are particularly interested in comments responding to whether the proposed rules achieve that appropriate balance.

C. *Municipal Bond Opinions*

The proposed regulations withdraw the proposed amendments to §10.39 governing requirements for State or local bond opinions, and remove the definition of, and exclusion for, State or local bond opinions from the definition of covered opinions in §10.35. The previously proposed amendments to §10.39 are no longer necessary because these proposed regulations remove entirely the concept of covered opinions from Circular 230. Under these proposed regulations, practitioners rendering opinions concerning the tax treatment of municipal bonds are subject to the standards in §10.37, the same professional standards that apply to all written tax advice.

2. *Procedures to Ensure Compliance*

Current §10.36(a) provides requirements for procedures to ensure compliance with §10.35. Because these proposed regulations remove current §10.35, these regulations also remove current §10.36(a). Treasury and the IRS, however, are proposing a new §10.36 to ensure compliance with Circular 230 generally.

The procedures to ensure compliance have produced great successes in encouraging firms to self-regulate, without the excessive burden often associated with a rigid one-size-fits-all approach. Treasury and the IRS expanded §10.36 in June 2011 to require firms to have procedures in place to ensure Circular 230 compliance with respect to a firm's tax return preparation practice. Under §10.36 of these proposed regulations, the requirement for procedures to ensure compliance are expanded to include all provisions of Circular 230.

Firm responsibility is a critical factor in ensuring high quality advice and representation for taxpayers. Accordingly, Treasury and the IRS conclude that firm management with principal authority and responsibility for overseeing a firm's practice governed by Circular 230 should be responsible for establishing procedures to ensure compliance with all provisions of Circular 230, and not merely the provisions regarding tax advice and tax return preparation. For purposes of §10.36, "principal" management will be interpreted in a manner consistent with its use in §1.6694–2(a)(2) and Notice 2007–39.

3. *General Standard of Competence*

Proposed §10.35 provides that a practitioner must exercise competence when engaged in practice before the IRS. Although a practitioner can be sanctioned for incompetent conduct under §10.51, no provision of Circular 230 specifically requires a practitioner to exercise competence when engaged in practice before the IRS. Section 10.35 is revised, therefore, to clarify that a practitioner must possess the necessary competence when engaged in practice before the IRS. Proposed §10.35 specifies that competent practice requires the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.

4. *Electronic Negotiation of Taxpayer Refunds*

Proposed §10.31 provides that a practitioner may not endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, into an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated) issued to a client by the government in respect of a Federal tax liability.

Treasury and the IRS are proposing to revise §10.31 to clarify that the prohibition on practitioner negotiation of taxpayer refunds applies in the modern-day electronic environment in which the IRS and practitioners operate today. The proposed regulations also expand §10.31 to apply to all individuals who practice before the IRS, not just those practitioners who are tax return preparers. Treasury and the IRS continue to encounter a small number of unscrupulous preparers and practitioners who attempt to manipulate the electronic refund process with the intent to defraud their clients and the IRS. The proposed regulations clarify that it constitutes disreputable conduct for a practitioner to direct the payment (or accept payment) of

any monies issued to a client by the government in respect of a Federal tax liability to the practitioner or any firm or entity with which the practitioner is associated and that such conduct is subject to sanction.

5. *Expedited Suspension Procedures*

Section 10.82 of the current regulations authorizes the immediate suspension of a practitioner who has engaged in certain conduct. The proposed regulations extend the expedited disciplinary procedures to disciplinary proceedings against practitioners who have willfully failed to comply with their Federal tax filing obligations. Treasury and the IRS issued a notice of proposed rulemaking in 2006, which included provisions that proposed extension of the availability of the expedited suspension procedures to practitioners not compliant with tax filing and payment obligations. See 71 FR 6421. These provisions were not finalized in the attendant 2007 final regulations due to practitioners' concerns that the proposed rule would erode due process rights. See 72 FR 54540. Treasury and the IRS continue, however, to encounter practitioners who demonstrate they are unfit to practice by repeatedly failing to comply with their own tax obligations.

Accordingly, these proposed regulations permit prompt action against practitioners who have engaged in a pattern of willful disreputable conduct as demonstrated by non-compliance with their Federal tax obligations, but in a manner more narrowly tailored than the 2006 proposal. These proposed regulations only permit the use of expedited procedures in the limited circumstances when a noncompliant practitioner demonstrates a pattern of willful disreputable conduct by (1) failing to make an annual Federal tax return during four of five tax years immediately before the institution of an expedited suspension proceeding; or (2) failing to make a return required more frequently than annually during five of seven tax periods immediately before the institution of an expedited suspension proceeding. For purposes of proposed §10.82, the phrase "make a return" has the same meaning as used in sections 6011 and 6012 of the Internal Revenue Code and §10.51(a)(6) of this part. Additionally, the practitioner must be noncompliant with a tax filing obligation at the time the notice of suspension is served on the practitioner for the expedited procedures to apply.

Unlike the previously proposed regulations, these proposed regulations do not permit the use of expedited suspension proceedings against practitioners who have not paid their Federal tax obligations. This modification responds to commentators' concern that a practitioner's failure to pay can be precipitated by circumstances outside of the practitioner's control and that it may be inequitable to suspend a practitioner expeditiously in these situations. Treasury and the IRS conclude, however, that expedited suspension is appropriate for practitioners who have not complied with basic tax filing obligations for the immediately preceding four of five years for annual returns (or five of seven tax periods). Practitioners engaging in this repeated pattern of non-filing demonstrate a high level of disregard for the Federal tax system and a level of willfulness sufficient for practitioner sanction under Circular 230. Treasury and the IRS have determined that the proposed rule is appropriate because practitioners demonstrating this high level of disregard for the Federal tax system are unfit to represent others who are making a good faith attempt to comply with their own Federal tax obligations. Expedited action in these cases will likely prevent harm to these taxpayers and the Federal tax system.

Current §10.82(f)(2) provides that a suspension under the expedited procedures is effective until the suspension is lifted by the IRS, an Administrative Law Judge, or the Secretary of the Treasury. Circular 230 does not otherwise provide guidance with respect to the length of suspension or the time period in which the practitioner is permitted to apply for reinstatement. Section 10.81, however, currently provides that a disbarred practitioner (or disqualified appraiser) may apply for reinstatement after five years following the practitioner's disbarment or disqualification. Proposed §10.81 makes these rules consistent and applies the same five-year time period for both disbarred and suspended practitioners.

Treasury and IRS are also proposing several non-substantive changes to the terms of §10.82 that will help practitioners distinguish between the expedited suspension procedures of §10.82 and otherwise generally applicable procedures for sanctions instituted under §10.60. For example, to begin an expedited suspension under the proposed regulations, the IRS would issue a "show cause order" instead of a "complaint" and the practitioner would submit a "response" instead of an "answer." The terms "complaint" and "answer" are currently used to describe the documents used in both expedited suspensions under §10.82 and regular proceedings under §10.60. These revisions do not generally change current expedited suspension procedures, or the contents of what must be included in the underlying documents, but are proposed to make §10.82 easier to understand.

Proposed §10.82(g) clarifies that practitioners subject to an expedited proceeding may demand a complaint under §10.60, and that the demand must specifically reference the suspension action under §10.82. Current §10.82(g) provides that the IRS has 30 days to issue a complaint after receiving the practitioner's demand for a complaint. In some cases, extra time may be necessary to provide the practitioner and Administrative Law Judge with the most current information regarding the practitioner's fitness to practice before the IRS. Treasury and the IRS have determined that 45 days will provide the IRS with sufficient time to ensure the complaint complies with the requirements in §10.62. Accordingly, proposed §10.82(g) provides that the IRS has 45 days to issue a complaint after receiving a demand for a complaint from a practitioner suspended under the expedited procedures.

6. Scope of the Office of Professional Responsibility

IRS and Treasury propose revising current §10.1 to clarify that the Office of Professional Responsibility has exclusive responsibility for matters related to practitioner discipline, including disciplinary proceedings and sanctions.

Effect on Other Documents

Notice 2005–47, 2005–1 C.B. 1373, will be obsolete beginning on the date that final regulations are published in the **Federal Register**.

Availability of IRS Documents

IRS notices cited in this preamble are made available by the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402.

Special Analyses

It has been determined that this proposed rule is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. 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. The proposed rule affects practitioners who practice before the IRS. Persons authorized to practice before the IRS have long been required to comply with certain standards of conduct, and those who provide written tax advice currently must comply with specific rules for this advice. Because these proposed rules replace the rigid rules for written tax advice with more flexible rules and eliminate the necessity to provide disclaimers in certain written tax advice, these rules will reduce the burden imposed on small entities that issue written tax advice. Therefore, the updating amendments and requirements for written advice imposed by these 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. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are timely submitted to the IRS as prescribed in this preamble under the "Addresses" heading. Treasury and the IRS request comments on all aspects of the proposed rules. All comments will be available at *www.regulations.gov* or upon request.

The public hearing is scheduled for December 7, 2012, from 10 a.m., and will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. 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 comments by November 16, 2012, and an outline of the topics to be discussed, and the time to be devoted to each topic by November 16, 2012. A period of 10 minutes will be allocated 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 author of these regulations is Matthew D. Lucey of the Office of the Associate Chief Counsel (Procedure and Administration).

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Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 31 CFR part 330, the notice of proposed rulemaking (REG–159824–04) that was published in the **Federal Register** on December 20, 2004 (69 FR 75887) is withdrawn.

Proposed Amendments to the Regulations

Accordingly, 31 CFR part 10 is proposed to be amended as follows:

PART 10—PRACTICE BEFORE THE INTERNAL REVENUE SERVICE

Paragraph 1. The authority citation for 31 CFR part 10 continues to read as follows:

Authority: Sec. 3, 23 Stat. 258, secs. 2–12, 60 Stat. 237 *et. seq.*; 5 U.S.C. 301, 500, 551–559; 31 U.S.C. 321; 31 U.S.C. 330; Reorg. Plan No. 26 of 1950, 15 FR 4935, 64 Stat. 1280, 3 CFR, 1949–1953 Comp., p. 1017.

Par. 2. Section 10.1 is amended by revising paragraphs (a)(1) and (d) to read as follows:

§10.1 Offices.

(a) * * *

(1) The Office of Professional Responsibility, which shall generally have responsibility for matters related to practitioner conduct and shall have exclusive responsibility for discipline, including disciplinary proceedings and sanctions; and

* * * * *

(d) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register.**

Par. 3. Section 10.3 is amended by revising paragraphs (a), (b), (g), and (j) to read as follows:

§10.3 Who may practice.

(a) *Attorneys.* Any attorney who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that the attorney is currently qualified as an attorney and is authorized to represent the party or parties. Notwithstanding the preceding sentence, attorneys who are not currently under suspension or disbarment from practice before the Internal Revenue Service are not required to file a written declaration with the IRS before rendering written advice covered under §10.37, but their rendering of this advice is practice before the Internal Revenue Service.

(b) *Certified public accountants.* Any certified public accountant who is not currently under suspension or disbarment from practice before the Internal Revenue Service may practice before the Internal Revenue Service by filing with the Internal Revenue Service a written declaration that the certified public accountant is currently qualified as a certified public accountant and is authorized to represent the party or parties. Notwithstanding the preceding

sentence, certified public accountants who are not currently under suspension or disbarment from practice before the Internal Revenue Service are not required to file a written declaration with the IRS before rendering written advice covered under §10.37, but their rendering of this advice is practice before the Internal Revenue Service.

* * * * *

(g) *Others.* Any individual qualifying under §10.5(e) or §10.7 is eligible to practice before the Internal Revenue Service to the extent provided in those sections.

* * * * *

(j) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register**.

Par. 4. Section 10.22 is amended by revising paragraphs (b) and (c) to read as follows:

§10.22 Diligence as to accuracy.

* * * * *

(b) *Reliance on others.* Except as provided in §§10.34 and 10.37, a practitioner will be presumed to have exercised due diligence for purposes of this section if the practitioner relies on the work product of another person and the practitioner used reasonable care in engaging, supervising, training, and evaluating the person, taking proper account of the nature of the relationship between the practitioner and the person.

(c) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register**.

Par. 5. Section 10.31 is revised to read as follows:

§10.31 Negotiation of taxpayer checks.

(a) A practitioner may not endorse or otherwise negotiate any check (including directing or accepting payment by any means, electronic or otherwise, in an account owned or controlled by the practitioner or any firm or other entity with whom the practitioner is associated) issued to a client by the government in respect of a Federal tax liability.

(b) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register**.

Par. 6. Section 10.35 is revised to read as follows:

§10.35 Competence.

(a) A practitioner must possess the necessary competence to engage in practice before the Internal Revenue Service. Competent practice requires the knowledge, skill, thoroughness, and preparation necessary for the matter for which the practitioner is engaged.

(b) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register**.

Par. 7. Section 10.36 is revised to read as follows:

§10.36 Procedures to ensure compliance.

(a) Any practitioner who has (or practitioners who have or share) principal authority and responsibility for overseeing a firm's practice governed by this part, including the provision of advice concerning Federal tax matters and preparation of tax returns, claims for refund, or other documents for submission to the Internal Revenue Service, must take reasonable steps to ensure that the firm has adequate procedures in effect for all members, associates, and employees for purposes of complying with this part, as applicable. Any practitioner who has (or practitioners who have or share) this principal authority will be subject to discipline for failing to comply with the requirements of this paragraph (a) if—

(1) The practitioner through willfulness, recklessness, or gross incompetence does not take reasonable steps to ensure that the firm has adequate procedures to comply with this part, as applicable, and one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, of failing to comply with this part, as applicable; or

(2) The practitioner knows or should know that one or more individuals who are members of, associated with, or employed by, the firm are, or have, engaged in a pattern or practice, in connection with their practice with the firm, that does not comply with this part, as applicable, and the practitioner, through willfulness, recklessness, or gross incompetence fails to take prompt action to correct the noncompliance.

(b) *Effective/applicability date.* This section is applicable beginning after the date that final regulations are published in the **Federal Register**.

Par. 8. Section 10.37 is revised to read as follows:

§10.37 Requirements for written advice.

(a) *Requirements.* (1) A practitioner may give written advice (including by means of electronic communication) concerning one or more Federal tax matters subject to the requirements in paragraph (a)(2) of this section.

(2) The practitioner must—

(i) Base the written advice on reasonable factual and legal assumptions (including assumptions as to future events);

(ii) Reasonably consider all relevant facts that the practitioner knows or should know;

(iii) Use reasonable efforts to identify and ascertain the facts relevant to written advice on each Federal tax matter;

(iv) Not rely upon representations, statements, findings, or agreements (including projections, financial forecasts, or appraisals) of the taxpayer or any other person if reliance on them would be unreasonable; and

(v) Not, in evaluating a Federal tax matter, take into account the possibility that a tax return will not be audited or that a matter will not be raised on audit.

(3) Reliance on representations, statements, findings, or agreements is unreasonable if the practitioner knows or should know that one or more representations or assumptions on which any representation is based are incorrect or incomplete.

(b) *Reliance on advice of others.* A practitioner may only rely on the advice of another practitioner if the advice was reasonable and the reliance is in good faith considering all the facts and circumstances. Reliance is not reasonable when—

(1) The practitioner knows or should know that the opinion of the other practitioner should not be relied on;

(2) The practitioner knows or should know that the other practitioner is not com-

petent or lacks the necessary qualifications to provide the advice; or

(3) The practitioner knows or should know that the other practitioner has a conflict of interest as described in this part.

(c) *Standard of review*. (1) In evaluating whether a practitioner giving written advice concerning one or more Federal tax matters complied with the requirements of this section, the Commissioner, or delegate, will apply a reasonableness standard, considering all facts and circumstances, including, but not limited to, the scope of the engagement and the type and specificity of the advice sought by the client.

(2) In the case of an opinion the practitioner knows or has reason to know will be used or referred to by a person other than the practitioner (or a person who is a member of, associated with, or employed by the practitioner's firm) in promoting, marketing, or recommending to one or more taxpayers a partnership or other entity, investment plan or arrangement a significant purpose of which is the avoidance or evasion of any tax imposed by the Internal Revenue Code, the determination of whether a practitioner has failed to comply with this section will be made on the basis of a heightened standard of review because of the greater risk caused by the practitioner's lack of knowledge of the taxpayer's particular circumstances.

(d) *Effective/applicability date*. The rules of this section will apply to written advice that is rendered after the date of publication of the Treasury decision adopting these rules as final regulations in the **Federal Register.**

Par. 9. Section 10.52 is revised to read as follows:

§10.52 Violations subject to sanction.

(a) A practitioner may be sanctioned under §10.50 if the practitioner—

(1) Willfully violates any of the regulations (other than §10.33) contained in this part; or

(2) Recklessly or through gross incompetence (within the meaning of §10.51(a)(13)) violates §§10.34, 10.36, or 10.37.

(b) *Effective/applicability date*. This section is applicable to conduct occurring on or after the date final regulations are published in the **Federal Register**.

Par. 10. Section 10.81 is revised to read as follows:

§10.81 Petition for reinstatement.

(a) *In general.* A practitioner disbarred or suspended under §10.60, or suspended under §10.82, or a disqualified appraiser may petition for reinstatement before the Internal Revenue Service after the expiration of 5 years following such disbarment, suspension, or disqualification. Reinstatement will not be granted unless the Internal Revenue Service is satisfied that the petitioner is not likely to engage thereafter in conduct contrary to the regulations in this part, and that granting such reinstatement would not be contrary to the public interest.

(b) *Effective/applicability date.* This section is applicable beginning on the date final regulations are published in the **Federal Register**.

Par 11. Section 10.82 is amended by:

1. Revising paragraph (a) and the introductory text of paragraph (b).

2. Adding paragraph (b)(5).

3. Revising paragraphs (c), (d), (e), (f), (g), and (h).

The revisions and additions read as follows:

§10.82 Expedited suspension.

(a) *When applicable.* Whenever the Commissioner, or delegate, determines that a practitioner is described in paragraph (b) of this section, the expedited procedures described in this section may be used to suspend the practitioner from practice before the Internal Revenue Service.

(b) *To whom applicable*. This section applies to any practitioner who, within 5 years prior to the date that a show cause order under this section's expedited suspension procedures is served:

* * * * *

(5) Has demonstrated a pattern of willful disreputable conduct by—

(i) Failing to make an annual Federal tax return, in violation of the Federal tax laws, during 4 of the 5 tax years immediately preceding the institution of a proceeding under paragraph (c) of this section and remains noncompliant with any of the practitioner's Federal tax filing obligations at the time the notice of suspension is issued under paragraph (f) of this section; or

(ii) Failing to make a return required more frequently than annually, in violation of the Federal tax laws, during 5 of the 7 tax periods immediately preceding the institution of a proceeding under paragraph (c) of this section and remains noncompliant with any of the practitioner's Federal tax filing obligations at the time the notice of suspension is issued under paragraph (f) of this section.

(c) *Expedited suspension procedures.* A suspension under this section will be proposed by a show cause order that names the respondent, is signed by an authorized representative of the Internal Revenue Service under §10.69(a)(1), and served according to the rules set forth in paragraph (a) of §10.63. The show cause order must give a plain and concise description of the allegations that constitute the basis for the proposed suspension. The show cause order must notify the respondent—

(1) Of the place and due date for filing a response;

(2) That an expedited suspension decision by default may be rendered if the respondent fails to file a response as required;

(3) That the respondent may request a conference to address the merits of the show cause order and that any such request must be made in the response; and

(4) That the respondent may be suspended either immediately following the expiration of the period within which a response must be filed or, if a conference is requested, immediately following the conference.

(d) *Response.* The response to the show cause order described in this section must be filed no later than 30 calendar days following the date the show cause order is served, unless the time for filing is extended. The response must be filed in accordance with the rules set forth for answers to a complaint in §10.64, except as otherwise provided in this section. The response must include a request for a conference, if a conference is desired. The respondent is entitled to the conference only if the request is made in a timely filed response.

(e) *Conference*. An authorized representative of the Internal Revenue Service will preside at a conference described in this section. The conference will be held

at a place and time selected by the Internal Revenue Service, but no sooner than 14 calendar days after the date by which the response must be filed with the Internal Revenue Service, unless the respondent agrees to an earlier date. An authorized representative may represent the respondent at the conference.

(f) *Suspension*—(1) *In general*. The Commissioner, or delegate, may suspend the respondent from practice before the Internal Revenue Service by a written notice of expedited suspension immediately following:

(i) The expiration of the period within which a response to a show cause order must be filed if the respondent does not file a response as required by paragraph (d) of this section;

(ii) The conference described in paragraph (e) of this section if the Internal Revenue Service finds that the respondent is described in paragraph (b) of this section;

(iii) The respondent's failure to appear, either personally or through an authorized representative, at a conference scheduled by the Internal Revenue Service under paragraph (e) of this section.

(2) *Duration of suspension*. A suspension under this section will commence on the date that the written notice of expedited suspension is served on the practitioner, either personally or through an authorized representative. The suspension will remain effective until the earlier of:

(i) The date the Internal Revenue Service lifts the suspension after determining that the practitioner is no longer described in paragraph (b) of this section or for any other reason; or

(ii) The date the suspension is lifted by an Administrative Law Judge or the Secretary of the Treasury, or delegate deciding appeals, in a proceeding referred to in paragraph (g) of this section and instituted under §10.60.

(g) *Practitioner request for §10.60 proceeding*. If the Internal Revenue Service suspends a practitioner under the expedited suspension procedures described in this section, the practitioner may demand that the Internal Revenue Service institute a proceeding under §10.60 and issue the complaint described in §10.62. The request must be in writing, specifically reference the suspension action under §10.82, and be made within 2 years from the date on which the practitioner's suspension commenced. The Internal Revenue Service must issue a complaint demanded under this paragraph (g) within 45 calendar days of receiving the demand.

(h) *Effective/applicability date*. This section is applicable beginning on the date that final regulations are published in the **Federal Register.**

Par. 12. Section 10.91 is revised to read as follows:

§10.91 Saving provision.

Any proceeding instituted under this part prior to the date that final regulations are published in the **Federal Register**, for which a final decision has not been reached or for which judicial review is still available is not affected by these revisions. Any proceeding under this part based on conduct engaged in prior to the date that final regulations are published in the **Federal Register**, which is instituted after that date, will apply subpart D and E of this part as revised, but the conduct engaged in prior to the effective date of these revisions will be judged by the regulations in effect at the time the conduct occurred.

Par. 13. Section 10.93 is revised to read as follows:

§10.93 Effective date.

Except as otherwise provided in each section and subject to §10.91, Part 10 is applicable on the date that final regulations are published in the **Federal Register**.

Steven T. Miller,
Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on September 14, 2012, 8:45 a.m., and published in the issue of the Federal Register for September 17, 2012, 77 F.R. 57055)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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