

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2004-70, page 460.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the second half of 2004 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61-21(g) of the regulations.

Rev. Rul. 2004-92, page 466.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2004, will be 5 percent for overpayments (4 percent in the case of a corporation), 5 percent for underpayments, and 7 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 will be 2.5 percent.

Rev. Rul. 2004-93, page 462.

LIFO; price indexes; department stores. The July 2004 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 2004.

T.D. 9147, page 461.

REG-171386-03, page 477.

Temporary and proposed regulations amend the regulations under section 163(d) of the Code to provide the rules relating to how and when taxpayers may elect to take qualified dividend income into account as investment income for purposes of calculating the deduction for investment income expense.

T.D. 9148, page 460.

Final regulations under section 83 of the Code provide that the transfer of a compensatory stock option to a related person will not be treated as an arm's length transaction, meaning that section 83 will continue to apply and the original holder of the option may realize further compensation income at the time of exercise of the option. The regulations also provide a definition of a related person.

REG-108637-03, page 472.

Proposed regulations under section 1275 of the Code provide rules for the accrual of original issue discount (OID) on certain real estate mortgage investment conduit (REMIC) regular interests. The regulations provide guidance to REMICs, REMIC regular interest holders and information reporters regarding the accrual of OID. A public hearing is scheduled for November 17, 2004.

REG-154077-03, page 476.

Proposed regulations under section 860F of the Code discuss the definition of partnership item for purposes of applying the unified partnership audit procedures to real estate mortgage investment conduits (REMICs).

REG-129706-04, page 478.

Proposed regulations under section 368 of the Code provide that in order to qualify as a tax-free reorganization, a transaction must meet certain requirements. One such requirement is that the owners of the corporation being acquired exchange their interests in the acquired corporation for a substantial interest in the acquiring corporation. These regulations explain the circumstances in which the determination will be made of whether the owners of the acquired corporation have exchanged their interests for a substantial interest in the acquiring corporation by reference to the signing date value of the acquiring corporation stock to be issued in the transaction.

(Continued on the next page)

Finding Lists begin on page ii.



REG-136481-04, page 480.

Proposed regulations under section 861 of the Code describe the proper basis for determining the source of compensation for labor or personal services performed partly within and partly without the United States. REG-208254-90 withdrawn.

EXCISE TAX

T.D. 9145, page 464.

REG-120616-03, page 474.

Final, temporary, and proposed regulations under section 4081 of the Code relate to the entry of taxable fuel into the United States. The regulations affect enterers of taxable fuel, certain other importers of record, and certain sureties.

The IRS Mission

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

applying the tax law with integrity and fairness to all.

Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

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

Section 61.—Gross Income Defined

26 CFR 1.61–21: Taxation of fringe benefits.

Fringe benefits aircraft valuation formula. The Standard Industry Fare Level (SIFL) cents-per-mile rates and terminal charges in effect for the second half of 2004 are set forth for purposes of determining the value of noncommercial flights on employer-provided aircraft under section 1.61–21(g) of the regulations.

Rev. Rul. 2004–70

For purposes of the taxation of fringe benefits under section 61 of the Internal Revenue Code, section 1.61–21(g) of the Income Tax Regulations provides a rule for valuing noncommercial flights on employer-provided aircraft. Section 1.61–21(g)(5) provides an aircraft valuation formula to determine the value of such flights. The value of a flight is determined under the base aircraft valuation formula (also known as the Standard Industry Fare

Level formula or SIFL) by multiplying the SIFL cents-per-mile rates applicable for the period during which the flight was taken by the appropriate aircraft multiple provided in section 1.61–21(g)(7) and then adding the applicable terminal charge. The SIFL cents-per-mile rates in the formula and the terminal charge are calculated by the Department of Transportation and are reviewed semi-annually.

The following chart sets forth the terminal charges and SIFL mileage rates:

<i>Period During Which the Flight Is Taken</i>	<i>Terminal Charge</i>	<i>SIFL Mileage Rates</i>
7/1/04 - 12/31/04	\$35.21	Up to 500 miles = \$.1926 per mile 501–1500 miles = \$.1469 per mile Over 1500 miles = \$.1412 per mile

DRAFTING INFORMATION

The principal author of this revenue ruling is Kathleen Edmondson of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue ruling, contact Ms. Edmondson at (202) 622–6040 (not a toll-free call).

Section 83.—Property Transferred in Connection With Performance of Services

26 CFR 1.83–7: Taxation of nonqualified stock options.

T.D. 9148

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Transfers of Compensatory Options

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains regulations that provide rules governing transfers of certain compensatory stock options (nonstatutory stock options). The regulations affect persons who have been granted

nonstatutory stock options, as well as service recipients who may be entitled to deductions related to the options.

DATES: Effective Date: These regulations are effective August 10, 2004.

Applicability Dates: These regulations apply to transfers of nonstatutory stock options on or after July 2, 2003.

FOR FURTHER INFORMATION CONTACT: Stephen Tackney (202) 622–6030 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

These regulations amend 26 CFR part 1. On July 2, 2003, a temporary regulation (T.D. 9067, 2003–32 I.R.B. 287) relating to transfers of compensatory options was published in the **Federal Register** (68 FR 39453). A notice of proposed rulemaking (REG–116914–03, 2003–32 I.R.B. 338) was published in the **Federal Register** for the same day (68 FR 39498). No public hearing was requested or held. No written or electronic comments responding to

the notice of proposed rulemaking were received. The proposed regulations are adopted without change by this Treasury decision, and the corresponding temporary regulations are removed.

Special Analyses

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

Drafting Information

The principal author of these final regulations is Stephen Tackney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for “1.83–7T” and continues to read in part as follows:

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

Par. 2. §1.83–7 is amended as follows:

1. Paragraph (a) is amended by adding two sentences at the end.

2. Paragraphs (a)(1) and (a)(2) are added.

3. Paragraph (d) is revised.

The additions read as follows:

§1.83–7 Taxation of nonqualified stock options.

(a) * * * The preceding sentence does not apply to a sale or other disposition of the option to a person related to the service provider that occurs on or after July 2, 2003. For this purpose, a person is related to the service provider if—

(1) The person and the service provider bear a relationship to each other that is specified in section 267(b) or 707(b)(1), subject to the modifications that the language “20 percent” is used instead of “50 percent” each place it appears in sections 267(b) and 707(b)(1), and section 267(c)(4) is applied as if the family of an individual includes the spouse of any member of the family; or

(2) The person and the service provider are engaged in trades or businesses under common control (within the meaning of section 52(a) and (b)); provided that a person is not related to the service provider if the person is the service recipient with respect to the option or the grantor of the option.

* * * * *

(d) This section applies on and after July 2, 2003. For transactions prior to that date, see §1.83–7 as published in 26 CFR Part 1 (revised as of April 1, 2003).

§1.83–7T [Removed]

Par. 3. Section 1.83–7T is removed.

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

Approved July 28, 2004.

Gregory Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48392)

Section 163.—Interest

26 CFR 1.163(d)–1: Time and manner for making elections under the Omnibus Budget Reconciliation

Act of 1993 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

T.D. 9147

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Time and Manner of Making §163(d)(4)(B) Election to Treat Qualified Dividend Income as Investment Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to an election that may be made by noncorporate taxpayers to treat qualified dividend income as investment income for purposes of calculating the deduction for investment interest. The regulations reflect changes to the law made by the Jobs and Growth Tax Relief Reconciliation Act of 2003. The regulations affect taxpayers making the election under section 163(d)(4)(B) to treat qualified dividend income as investment income. The text of these temporary regulations also serves as the text of the proposed regulations (REG–171386–03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective August 5, 2004.

Applicability Dates: For dates of applicability, see §1.163(d)–1T(d).

FOR FURTHER INFORMATION CONTACT: Amy Pfalzgraf, (202) 622–4950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Section 163(d)(1) provides that the investment interest deduction for a noncorporate taxpayer for any taxable year is limited to the net investment income of

the taxpayer for the taxable year. Section 163(d)(4)(A) defines “net investment income” as the excess of investment income over investment expenses. Section 163(d)(4)(B)(iii) provides that an electing taxpayer may take all or a portion of certain net capital gain attributable to dispositions of property held for investment into account as investment income. Section 1(h)(2) provides that any net capital gain taken into account as investment income is not eligible to be taxed at the capital gains rates.

Section 302(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003, (Public Law 108–27, 117 Stat. 762) (JGTRRA 2003), amended section 163(d)(4)(B) to provide that an electing taxpayer may take all or a portion of qualified dividend income (as defined in section 1(h)(11)(B)) into account as investment income. Section 302(a) of JGTRRA 2003 added new section 1(h)(11)(D) to provide that any qualified dividend income taken into account as investment income is not eligible to be taxed at the capital gains rates.

Section 1.163(d)–1 of the Income Tax Regulations provides rules regarding the time and manner for making the net capital gain election under section 163(d)(4)(B)(iii). These regulations amend §1.163(d)–1 to provide that the rules regarding the time and manner for making the qualified dividend income election under section 163(d)(4)(B) are the same as the rules for making the net capital gain election under section 163(d)(4)(B)(iii).

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For application of the Regulatory Flexibility Act (5 U.S.C. chapter 6) please refer to the cross-reference notice of proposed rule-making published elsewhere in this issue of the Bulletin. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small

Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Amy Pfalzgraf of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

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Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

Part 1—INCOME TAXES

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

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

Par. 2. Section 1.163(d)–1 is revised.

§1.163(d)–1 Time and manner for making elections under the Omnibus Budget Reconciliation Act of 1993 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

(a) [Reserved]. For further guidance, see §1.163(d)–1T(a).

(b) [Reserved]. For further guidance, see §1.163(d)–1T(b).

(c) [Reserved]. For further guidance, see §1.163(d)–1T(c).

(d) [Reserved]. For further guidance, see §1.163(d)–1T(d).

Par. 3. Section 1.163(d)–1T is added to read as follows:

§1.163(d)–1T Time and manner for making elections under the Omnibus Budget Reconciliation Act of 1993 and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (temporary).

(a) *Description.* Section 163(d)(4)(B)(iii), as added by section 13206(d) of the Omnibus Budget Reconciliation Act of 1993 (Public Law 103–66, 107 Stat. 467), allows an electing taxpayer to take all or a portion of certain net capital gain attributable to dispositions of property held for investment into account as investment income. Section 163(d)(4)(B), as amended by section 302(b) of the Jobs and Growth Tax Relief Reconciliation Act of 2003 (Public Law 108–27, 117 Stat.

762), allows an electing taxpayer to take all or a portion of qualified dividend income, as defined in section 1(h)(11)(B), into account as investment income. As a consequence, the net capital gain and qualified dividend income taken into account as investment income under these elections are not eligible to be taxed at the capital gains rates. An election may be made for net capital gain recognized by noncorporate taxpayers during any taxable year beginning after December 31, 1992. An election may be made for qualified dividend income received by noncorporate taxpayers during any taxable year beginning after December 31, 2002, but before January 1, 2009.

(b) *Time and manner for making the elections.* The elections for net capital gain and qualified dividend income must be made on or before the due date (including extensions) of the income tax return for the taxable year in which the net capital gain is recognized or the qualified dividend income is received. The elections are to be made on Form 4952, “*Investment Interest Expense Deduction*,” in accordance with the form and its instructions.

(c) *Revocability of elections.* The elections described in this section are revocable with the consent of the Commissioner.

(d) *Effective date.* The rules set forth in this section regarding the net capital gain election are effective December 12, 1996. The rules set forth in this section regarding the qualified dividend income election apply to any taxable year beginning after December 31, 2002, but before January 1, 2009.

Nancy J. Jardini,
*Acting Deputy Commissioner for
Services and Enforcement.*

Approved July 29, 2004.

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

(Filed by the Office of the Federal Register on August 4, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 5, 2004, 69 F.R. 47364)

Section 472.—Last-in, First-out Inventories

26 CFR 1.472–1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The July 2004 Bureau of Labor

Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 2004.

Rev. Rul. 2004-93

The following Department Store Inventory Price Indexes for July 2004 were

issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, July 31, 2004.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups — soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	July 2003	July 2004	Percent Change from July 2003 to July 2004 ¹
1. Piece Goods	487.0	507.8	4.3
2. Domestic and Draperies	570.0	525.0	-7.9
3. Women's and Children's Shoes	613.9	608.5	-0.9
4. Men's Shoes	831.2	831.7	0.1
5. Infants' Wear	573.3	560.5	-2.2
6. Women's Underwear.....	509.0	508.0	-0.2
7. Women's Hosiery	346.9	330.4	-4.8
8. Women's and Girls' Accessories	537.8	565.8	5.2
9. Women's Outerwear and Girls' Wear	342.8	335.9	-2.0
10. Men's Clothing	533.3	532.7	-0.1
11. Men's Furnishings.....	562.7	567.0	0.8
12. Boys' Clothing and Furnishings	424.4	420.9	-0.8
13. Jewelry.....	882.3	907.8	2.9
14. Notions	792.1	798.6	0.8
15. Toilet Articles and Drugs	992.0	993.3	0.1
16. Furniture and Bedding	619.9	616.3	-0.6
17. Floor Coverings.....	587.3	587.7	0.1
18. Housewares.....	722.5	712.1	-1.4
19. Major Appliances.....	213.3	199.6	-6.4
20. Radio and Television.....	45.3	41.6	-8.2
21. Recreation and Education ²	82.8	80.3	-3.0
22. Home Improvements ²	123.7	129.8	4.9
23. Automotive Accessories ²	111.4	112.7	1.2
Groups 1-15: Soft Goods	549.6	545.1	-0.8
Groups 16-20: Durable Goods	394.3	382.3	-3.0
Groups 21-23: Misc. Goods ²	94.0	93.3	-0.7
Store Total ³	493.4	487.2	-1.3

¹Absence of a minus sign before the percentage change in this column signifies a price increase.

²Indexes on a January 1986 = 100 base.

³The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Michael Burkom of the Office

of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact

Mr. Burkom at (202) 622-7924 (not a toll-free call).

Section 4081.—Imposition of Tax

26 CFR 48.4081-1: Taxable fuel; definitions.

T.D. 9145

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Parts 48 and 602

Entry of Taxable Fuel

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations relating to the tax on the entry of taxable fuel into the United States. These regulations affect enterers of taxable fuel, other importers of record, and certain sureties. The text of the temporary regulations also serves as the text of the proposed regulations (REG-120616-03) set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on September 28, 2004.

Applicability Dates: For dates of applicability, see §§48.4081-1T(b) and 48.4081-3T(c)(2)(ii) and (iv).

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collection of information contained in these regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1897. Responses to this collection of information are required to obtain a tax benefit.

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

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

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

Background

Present Law

Section 4081(a)(1)(A)(iii) of the Internal Revenue Code (Code) imposes a tax on the entry into the United States of taxable fuel. Taxable fuel means gasoline, diesel fuel, and kerosene. Existing regulations provide that the enterer is liable for the tax imposed on the entry of taxable fuel.

The regulations currently define the term *enterer* as generally meaning the importer of record (under customs law) with respect to the taxable fuel. However, if the importer of record is acting as an agent (for example, the importer of record is a customs broker engaged by the owner of the taxable fuel), the person for whom the agent is acting is the enterer.

The regulations require an enterer to be registered by the IRS. The IRS will register an applicant only if the IRS determines that the applicant meets several tests, including the adequate security test. An applicant meets the adequate security test only if the IRS determines that the applicant has both adequate financial resources and a satisfactory tax history, or the applicant gives the IRS a bond.

Section 142.4 of the Customs regulations (19 CFR) provides that merchandise shall not be released from Customs custody unless a bond on Customs Form 301, Customs Bond, has been filed. This bond, which is filed by the importer of record,

secures the payment of any duty, tax, or charge, and compliance with Customs laws and regulations. Section 141.3 of the Customs regulations provides that the importer's liability for duties includes liability for any internal revenue taxes which attach upon the importation of merchandise, unless otherwise provided by law or regulation. Also, §113.62(a)(1)(ii) of the Customs regulations provides, in part, that if merchandise is imported and released from Customs custody, the obligors on a Customs bond (principal and surety, jointly and severally) agree to pay, as demanded by Customs, all additional duties, taxes, and charges subsequently found due, legally fixed, and imposed on any entry secured by the bond.

Reason for Change

The IRS has found that abusive situations exist with regard to the entry of taxable fuel into the United States. For example, some enterers are not registered and are not paying the tax on their fuel entries. This not only gives noncompliant enterers a competitive advantage over their compliant competitors, but it also deprives the United States Treasury of revenue intended for the Highway Trust Fund.

When Congress enacted the present fuel tax regime, it noted that the Treasury Department is permitted "to prescribe rules and administrative procedures for determining liability for payment of tax." H.R. Conf. Rep. No. 101-964, at 1052 (1990).

Explanation of Provisions

Pursuant to these temporary regulations, the importer of record (under Customs law) is jointly and severally liable with the enterer for the tax if the importer of record is not the enterer of the taxable fuel (that is, the importer of record is a customs broker engaged by the enterer) and the enterer is not a taxable fuel registrant. Thus, an importer of record engaged by an enterer and seeking assurance that it will not be jointly and severally liable for the enterer's tax liability should verify that the enterer is registered by the IRS. This temporary regulation is similar to §48.4081-2(c)(2) of the regulations, which provides that a terminal operator generally is jointly and severally liable for the tax imposed on the removal of taxable fuel from the rack if the terminal operator

allows an unregistered position holder to operate in its terminal.

Customs laws and regulations provide that the importer of record is liable for any duties or taxes that attach upon the importation of merchandise. Therefore, an importer of record's Customs bond secures not only the payment of duties, but also the payment of taxes that are imposed on the entry of merchandise, including taxable fuel. Consequently, under existing law, a surety could be compelled to meet a demand on a Customs bond if the excise tax on the entry of taxable fuel is not paid when due. However, the IRS will not charge a surety bond for this tax until the effective date of these temporary regulations. It should be noted, however, that under these temporary regulations the Customs bond posted for the entry of taxable fuel will not be charged for the section 4081 tax if the enterer is a taxable fuel registrant.

Special Analysis

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

Drafting Information

The principal author of these regulations is Celia Gabrysh, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS, the Treasury Department, and the Bureau of Customs and Border Protection, Department of Homeland Security, participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 48 and 602 are amended as follows:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read, in part, as follows:

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

Par. 2. In §48.4081-1, paragraph (b) is amended by adding a new sentence to the end of the definition of enterer to read as follows:

§48.4081-1 Taxable fuel; definitions.

* * * * *

(b) * * * This definition of enterer does not apply with respect to an entry if the definition of enterer in §48.4081-1T(b) is applicable with respect to that entry.

* * * * *

Par. 3. Section 48.4081-1T is added to read as follows:

§48.4081-1T Taxable fuel; definitions (temporary).

(a) [Reserved]. For further guidance, see §48.4081-1(a).

(b) *Definitions.*

Definitions of approved terminal or refinery through diesel-powered train [Reserved].

Enterer generally means, in the case of an entry of taxable fuel on or after September 28, 2004, the importer of record (under customs law) with respect to the taxable fuel, except that—

(1) If the importer of record is a customs broker engaged by the owner of the taxable fuel, the person for whom the broker is acting is the enterer; and

(2) If there is no importer of record for taxable fuel entered into the United States, the owner of the taxable fuel at the time it is brought into the United States is the enterer.

Definition of entry through (f)(2) [Reserved]. For further guidance, see §48.4081-1(b) definition of entry through (f)(2).

Par. 4. In §48.4081-3, paragraph (c) is amended by revising paragraph (c)(2) to read as follows:

§48.4081-3 Taxable fuel; taxable events other than removal at the terminal rack.

* * * * *

(c) * * *

(2) *Liability for tax—(i) In general.* The enterer is liable for the tax imposed under paragraph (c)(1) of this section.

(ii) through (iv) For further guidance, see §48.4081-3T(c)(2)(ii) through (iv).

* * * * *

Par. 5. Section 48.4081-3T is added to read as follows:

§48.4081-3T Taxable fuel; taxable events other than removal at the terminal rack (temporary).

(a) through (c)(2)(i) [Reserved]. For further guidance, see §48.4081-3(a) through (c)(2)(i).

(c)(2)(ii) *Joint and several liability of the importer of record.* In the case of an entry of taxable fuel on or after September 28, 2004, the importer of record with respect to the taxable fuel is jointly and severally liable with the enterer for the tax imposed under §48.4081-3(c)(1) if—

(A) The importer of record is not the enterer of the taxable fuel; and

(B) The enterer is not a taxable fuel registrant.

(iii) *Conditions for avoidance of liability.* The importer of record is not liable for the tax under paragraph (c)(2)(ii) of this section if, at the time of the entry, the importer of record—

(A) Has an unexpired notification certificate (as described in §48.4081-5) from the enterer; and

(B) Has no reason to believe that any information in the notification certificate is false.

(iv) *Customs bond.* In the case of an entry of taxable fuel on or after September 28, 2004, the Customs bond posted with respect to the importation of the fuel will not be charged for the tax imposed on the entry of the fuel if the enterer is a taxable fuel registrant. A surety bond will not be charged for the tax imposed on the entry of the fuel covered by the bond, if at the time of entry, the surety—

(A) Has an unexpired notification certificate (as described in §48.4081-5) from the enterer; and

(B) Has no reason to believe that any information in the notification certificate is false.

(d) through (j) [Reserved]. For further guidance, see §48.4081-3(d) through (j).

§48.4081-5 [Amended]

Par. 6. Section 48.4081-5 is amended as follows:

a. Paragraph (a) is amended by removing the language “48.4081-2(c)(3),” and by adding “48.4081-2(c)(2)(ii),

48.4081-3T(c)(2)(iii) and (iv),” in its place.

b. Paragraph (b)(2) is amended by removing the language “gasoline registrant” and adding “taxable fuel registrant” in its place.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT.

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

Authority: 26 U.S.C. 7805.

Par. 8. In §602.101, paragraph (b) is amended by adding an 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.
* * * * *	
48.4081-3T * * * * *	1545-1897

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

Approved July 14, 2004.

Gregory Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 29, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 30, 2004, 69 F.R. 45587)

Section 6621.—Determination of Rate of Interest

26 CFR 301.6621-1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning October 1, 2004, will be 5 percent for overpayments (4 percent in the case of a corporation), 5 percent for underpayments, and 7 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding \$10,000 will be 2.5 percent.

Rev. Rul. 2004-92

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under section 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 3 percentage points (2

percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding \$10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under section 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under section 6601 on any large corporate underpayment, the underpayment rate under section 6621(a)(2) is determined by substituting “5 percentage points” for “3 percentage points.” See section 6621(c) and section 301.6621-3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and section 301.6621-3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under section 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in

accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88-59, 1988-1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under section 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with section 6621 which, pursuant to section 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of July 2004 is 2 percent. Accordingly, an overpayment rate of 5 percent (4 percent in the case of a corporation) and an underpayment rate of 5 percent are established for the calendar quarter beginning October 1, 2004. The overpayment rate for the portion of a corporate overpayment exceeding \$10,000 for the calendar quarter beginning October 1, 2004, is 2.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning October 1, 2004, is 7 percent. These rates apply to amounts bearing interest during that calendar quarter.

Interest factors for daily compound interest for annual rates of 2.5 percent, 4 percent, 5 percent, and 7 percent are published in Tables 58, 61, 63, and 67 of Rev. Proc. 95-17, 1995-1 C.B. 556, 612, 615, 617, and 621.

Annual interest rates to be compounded daily pursuant to section 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Crystal Foster of the Office of Asso-

ciate Chief Counsel (Procedure & Administration). For further information regarding this revenue ruling, contact Ms. Foster at (202) 622-7326 (not a toll-free call).

TABLE OF INTEREST RATES
PERIODS BEFORE JUL. 1, 1975 — PERIODS ENDING DEC. 31, 1986
OVERPAYMENTS AND UNDERPAYMENTS

PERIOD	RATE	In 1995-1 C.B. DAILY RATE TABLE
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25, pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 — Dec. 31, 1998

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995-1 C.B. TABLE	PG	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573

TABLE OF INTEREST RATES
FROM JAN. 1, 1987 — Dec. 31, 1998 – Continued

	OVERPAYMENTS			UNDERPAYMENTS		
	RATE	1995-1 C.B. TABLE	PG	RATE	1995-1 C.B. TABLE	PG
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 — PRESENT
NONCORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	RATE	1995-1 C.B. TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	5%	63	617

TABLE OF INTEREST RATES
FROM JANUARY 1, 1999 — PRESENT
CORPORATE OVERPAYMENTS AND UNDERPAYMENTS

	OVERPAYMENTS			UNDERPAYMENTS		
	1995-1 C.B. RATE	TABLE	PG	1995-1 C.B. RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571
Jul. 1, 2002—Sep. 30, 2002	5%	15	569	6%	17	571
Oct. 1, 2002—Dec. 31, 2002	5%	15	569	6%	17	571
Jan. 1, 2003—Mar. 31, 2003	4%	13	567	5%	15	569
Apr. 1, 2003—Jun. 30, 2003	4%	13	567	5%	15	569
Jul. 1, 2003—Sep. 30, 2003	4%	13	567	5%	15	569
Oct. 1, 2003—Dec. 31, 2003	3%	11	565	4%	13	567
Jan. 1, 2004—Mar. 31, 2004	3%	59	613	4%	61	615
Apr. 1, 2004—Jun. 30, 2004	4%	61	615	5%	63	617
Jul. 1, 2004—Sep. 30, 2004	3%	59	613	4%	61	615
Oct. 1, 2004—Dec. 31, 2004	4%	61	615	5%	63	617

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 — PRESENT

	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581

TABLE OF INTEREST RATES FOR
LARGE CORPORATE UNDERPAYMENTS
FROM JANUARY 1, 1991 — PRESENT — Continued

	RATE	1995-1 C.B. TABLE	PG
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575
Jul. 1, 2002—Sep. 30, 2002	8%	21	575
Oct. 1, 2002—Dec. 30, 2002	8%	21	575
Jan. 1, 2003—Mar. 31, 2003	7%	19	573
Apr. 1, 2003—Jun. 30, 2003	7%	19	573
Jul. 1, 2003—Sep. 30, 2003	7%	19	573
Oct. 1, 2003—Dec. 31, 2003	6%	17	571
Jan. 1, 2004—Mar. 31, 2004	6%	65	619
Apr. 1, 2004—Jun. 30, 2004	7%	67	621
Jul. 1, 2004—Sep. 30, 2004	6%	65	619
Oct. 1, 2004—Dec. 31, 2004	7%	67	621

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING \$10,000
FROM JANUARY 1, 1995 — PRESENT

	RATE	1995-1 C.B. TABLE	PG
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1, 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566
Jul. 1, 2002—Sep. 30, 2002	3.5%	12	566
Oct. 1, 2002—Dec. 31, 2002	3.5%	12	566
Jan. 1, 2003—Mar. 31, 2003	2.5%	10	564
Apr. 1, 2003—Jun. 30, 2003	2.5%	10	564
Jul. 1, 2003—Sep. 30, 2003	2.5%	10	564
Oct. 1, 2003—Dec. 31, 2003	1.5%	8	562
Jan. 1, 2004—Mar. 31, 2004	1.5%	56	610
Apr. 1, 2004—Jun. 30, 2004	2.5%	58	612
Jul. 1, 2004—Sep. 30, 2004	1.5%	56	610
Oct. 1, 2004—Dec. 31, 2004	2.5%	58	612

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Accrual for Certain REMIC Regular Interests

REG-108637-03

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the accrual of original issue discount (OID) on certain real estate mortgage investment conduit (REMIC) regular interests. The proposed regulations are necessary to provide guidance to REMICs, REMIC regular interest holders and information reporters regarding the accrual of OID. This document also provides notice of a public hearing on the proposed regulations.

DATES: Written or electronic comments must be received by November 23, 2004. Outlines of topics to be discussed at the public hearing scheduled for November 17, 2004, must be received by October 27, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-108637-03), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-108637-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS — REG-108637-03). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations,

contact Rebecca Asta at (202) 622-3930. To be placed on the building access list for the hearing, contact Sonya Cruse at (202) 622-7180.

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

1. *General Background*

A debt instrument may provide for qualified stated interest (QSI) (that is, certain periodic payments of stated interest), OID, or both. Sections 163(e) and 1271 through 1275 provide rules for the treatment of OID on debt instruments. In general, the holder of a debt instrument includes OID in income as it accrues, even if the holder generally uses a cash method of accounting. A holder of a REMIC regular interest includes QSI in income under an accrual method of accounting because section 860B(b) requires that amounts includible in gross income with respect to a REMIC regular interest be determined under an accrual method.

For many debt instruments, only one or two days separate the date on which the holder becomes entitled to a payment (the record date) from the date on which the holder receives payment (the payment date). For REMIC regular interests, however, the record date may precede the payment date by 15 to 30 days.

2. *Current REMIC Accrual Practice*

Under the governing contract provisions, REMIC regular interests generally accrue interest from the issue date to the final record date, and holders become entitled to receive interest payments based on month-end record dates. The IRS and the Treasury Department understand, however, that, in general, REMIC servicers have interpreted the OID rules to require or permit holders' OID to accrue for tax purposes over the period from payment date to payment date and have treated QSI as accruing over the same periods. To compensate for accruing QSI and OID beyond the final record date to the final payment date, the servicers have treated QSI and OID on REMIC regular interests as not accruing from the date of issue for

a period equal to the number of days between the record date and payment date. In effect, for tax purposes, the tax accrual of QSI and OID lags the legal accrual of interest by the delayed payment period.

For tax purposes, as of the date a REMIC regular interest is purchased in the secondary market, the purchaser begins to accrue QSI and OID, and the seller ceases to accrue QSI and OID. A purchaser that holds the instrument until the final payment date or redemption accrues QSI and OID past the final record date as long as it holds the instrument. A purchaser that begins to accrue QSI and OID on the purchase date gives up the benefit of the lag in the beginning of the accrual period. As a result, the delayed accrual system causes the last secondary market purchaser of a REMIC regular interest to accrue for tax purposes an additional number of days of QSI and OID equal to the number of days between the record and payment dates, and too much QSI and OID is allocated to the last secondary purchaser of the REMIC regular interest. Moreover, because of principal payments, the holder will earn interest on a declining principal balance, while the lagging tax accruals will be based on a higher principal amount between record dates and payment dates in many instances. Consequently, a secondary market purchaser that is not the last secondary market purchaser will experience tax accruals in excess of legal entitlements if the regular interest has significant stated principal and bears interest at a stated rate.

3. *Overview of the Proposed Regulations*

The proposed rules address the misallocation of QSI and OID by creating a special rule for accruing OID on REMIC regular interests that provide for a delay between record and payment dates. Under the proposed regulations, the period over which OID accrues generally coincides with the period over which the holder's right to interest payments accrues under the governing contract provisions.

Generally, under the proposed regulations, if the terms of a REMIC regular interest provide for a delay between the record and payment dates, the initial accrual period begins on the date of issuance

of the regular interest, and the final accrual period ends on the final record date of that REMIC regular interest. By shifting the entire tax accrual schedule, this special rule allocates all QSI and OID to the period between the issue date and the final record date of the instrument and none to the period between the final record date and final payment date. For purposes of calculating OID in the final accrual period with the methodology described in section 1272(a)(6), but for no other purpose, payments on the REMIC regular interest after the end of that accrual period that are included in the stated redemption price at maturity of the instrument (such as the payment on the final payment date) are treated as being made during the final accrual period.

The IRS and Treasury Department recognize that, although the proposed regulations result in a more accurate allocation of QSI and OID among REMIC regular interest holders, some economic accuracy may be sacrificed by ending the accrual of OID before final payments are made on the regular interests. Therefore, the proposed regulations are limited to REMIC regular interests with delayed payment periods of fewer than 32 days. The regulation regarding REMIC regular interests with delayed payment periods of more than 31 days is reserved. The IRS and Treasury Department request comments on whether additional guidance is needed for these REMIC regular interests.

4. *Accrual of Qualified Stated Interest*

Section 1.1272-1(a) requires a holder to include QSI in income under the holder's regular method of accounting. Section 1.446-2(b) requires a holder, as well as the issuer, to accrue QSI ratably over the accrual period to which it is attributable. In addition, section 860B(b) requires a holder of a regular interest to accrue amounts into gross income regardless of the holder's overall method of accounting. The amounts that must be so accrued include QSI. The Treasury Department and the IRS understand that many REMIC servicers have accrued QSI over the same period as OID. It is intended that, with respect to the accrual periods referenced in §1.446-2(b), the initial accrual period for QSI will begin on the date of issuance and the final accrual period for QSI will

end on the final record date. As a result, the QSI accrues over the same period as the OID.

Proposed Effective Date

These regulations are proposed to apply to any REMIC regular interest issued after the date the final regulations are published in the **Federal Register**. The proposed regulations provide automatic consent for the holder of a REMIC regular interest to change its method of accounting for OID under the final regulations. The change is proposed to be made on a cut-off basis and, thus, does not affect REMIC regular interests issued before the date the final regulations are published in the **Federal Register**.

The Treasury Department and the IRS are concerned regarding the extent to which holders of REMIC regular interests will be aware that changes in accounting methods for QSI may be necessary to comply with the special rule in the proposed regulations. If a holder of REMIC regular interests relies on data provided on behalf of the REMIC rather than performing its own computations, the holder may be unaware that these rules will have required newly issued REMICs to alter the accrual periods over which interest reported to holders is computed. The Treasury Department and the IRS request comments on the way in which a change in accounting method for QSI should be effected.

The Treasury Department and the IRS request comments concerning the extent to which any other debt instruments provide for a significant delay between record and payment dates and, if some do, whether rules like those in the proposed regulations should be extended to them. Any comments received will be considered in connection with the publication of final regulations in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory flexibility assessment is not required. It has also been determined that section 553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of in-

formation on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small businesses.

Comments and Public Hearing

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

A public hearing has been scheduled for November 17, 2004, beginning at 10 a.m. in the Auditorium of the 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 written or electronic comments by November 23, 2004, and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by October 27, 2004. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the schedule of speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Rebecca Asta of the Office

of Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1271-0 is amended by adding entries for §1.1275-2(l) and (m) to read as follows:

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

* * * * *

§1.1275-2 Special rules relating to debt instruments.

* * * * *

(l) [Reserved]

(m) Special rule for certain REMIC regular interests.

(1) Scope.

(2) General rules.

(3) Special rule for calculation of OID in final accrual period.

(4) Definition of record date.

(5) Accrual of qualified stated interest.

(6) Example.

(7) Treatment of REMIC regular interests if the record dates and the payment dates are separated by more than thirty-one days.

(8) Effective date.

* * * * *

Par. 3. Section 1.1275-2 is amended by adding new paragraphs (l) and (m) to read as follows:

§1.1275-2 Special rules relating to debt instruments.

* * * * *

(l) [Reserved].

(m) *Special rules for certain REMIC regular interests*—(1) *Scope*. If the terms of a REMIC regular interest (as defined

in section 860G(a)(1)) provide for a delay between its record dates and the associated payment dates, the initial accrual period and final accrual period for that regular interest are determined under this paragraph (m). Except as provided in paragraph (m)(7) of this section, this paragraph (m) does not apply to a REMIC regular interest if the record dates and the payment dates are separated by more than thirty-one days.

(2) *General rules*—(i) *Initial accrual period*. The initial accrual period for a REMIC regular interest subject to this paragraph (m) begins on issuance of the REMIC regular interest.

(ii) *Final accrual period*. The final accrual period for a REMIC regular interest subject to this paragraph (m) ends on the final record date of the REMIC regular interest.

(3) *Special rule for calculation of OID in final accrual period*. In applying section 1272(a)(6)(A) to calculate OID in the final accrual period for a REMIC regular interest subject to this paragraph (m), payments after the end of the final accrual period of amounts included in the stated redemption price at maturity are treated as payments during the final accrual period.

(4) *Definition of record date*. For purposes of this paragraph (m), a *record date* of a REMIC regular interest is a date, provided by the terms of the REMIC regular interest, on which the holder becomes entitled to a payment (of interest or principal) that is to be made on a subsequent payment date.

(5) *Accrual of qualified stated interest*. See §1.446-2 for the accrual of qualified stated interest.

(6) *Example*. The following example illustrates the application of this paragraph (m).

Example. REMIC X issues regular interests on January 1, 2009. The terms of the regular interests provide for payments of interest and principal to the persons who hold the regular interests on the last day of the calendar month (the record date). Each such payment is to be made on the fifteenth day of the succeeding calendar month (the payment date). The last payment with respect to the regular interests issued by REMIC X is to be made on January 15, 2014, to persons who hold the regular interests on December 31, 2013. Under this paragraph (m), the initial accrual period begins on the date of issuance, January 1, 2009, and the last accrual period ends on the last record date, December 31, 2013.

(7) *Treatment of REMIC regular interests if the record dates and the payment*

dates are separated by more than thirty-one days. [Reserved.]

(8) *Effective date*—(i) *In general*. This paragraph (m) applies to REMIC regular interests issued after the date the final regulations are published in the **Federal Register**.

(ii) *Automatic consent to change method of accounting*. Taxpayers are hereby granted the Commissioner's consent under section 446(e) to change their method of accounting for REMIC regular interests to which this paragraph (m) applies if—

(A) The change involves changing accrual periods to accrual periods allowed by this paragraph (m);

(B) The change is made for the first taxable year of the taxpayer during which the taxpayer holds a REMIC regular interest to which the rules of this paragraph (m) apply; and

(C) The change in method of accounting is effected on a cut-off basis.

Deborah M. Nolan,
Acting Deputy Commissioner for Services and Enforcement.

(Filed by the Office of the Federal Register on August 24, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 25, 2004, 69 F.R. 52217)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Entry of Taxable Fuel REG-120616-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9145) relating to the tax on the entry of taxable fuel into the United States. The text of those regulations also serves as the text of these proposed regulations. The regulations affect enterers of taxable fuel, certain other importers, and certain sureties.

DATES: Written and electronic comments and requests for a public hearing must be received by October 28, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-120616-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Alternatively, 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-120616-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRule-making portal at www.regulations.gov (IRS and REG-120616-03).

FOR FURTHER INFORMATION CONTACT: Concerning submissions, LaNita Van Dyke (202) 622-7180; concerning the regulations, Celia Gabrysh (202) 622-3130 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by September 28, 2004. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

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

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

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

The collections of information in this proposed regulation are in §48.4081-3T(c)(2)(iii) and (iv). Section 48.4081-3T(c)(2)(iii) generally provides that an importer of record may avoid tax liability if the importer of record obtains from the enterer a notification certificate, described in §48.4081-5, which contains the enterer's registration number. Section 48.4081-3T(c)(2)(iv) generally provides that a surety bond will not be charged for the tax imposed on the entry of the fuel covered by the bond, if at the time of entry, the surety has a notification certificate, described in §48.4081-5, which contains the enterer's registration number. These collections of information are required to obtain a tax benefit. The likely respondents are businesses.

Estimated total annual reporting and/or recordkeeping burden: 281 hours.

Estimated average annual burden hours per respondent and/or recordkeeper varies from .25 hour to 2.25 hours, depending on individual circumstances, with an estimated average of 1.25 hours.

Estimated number of respondents and/or recordkeepers: 225.

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

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

Background

Temporary regulations in this issue of the Bulletin amend the Manufacturers and Retailers Excise Taxes Regulations (26 CFR Part 48) relating to the tax on the entry of taxable fuel imposed by section

4081. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory flexibility assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. 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 time required to request and to furnish a notification certificate is minimal and will not have a significant impact on those 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 will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Celia Gabrysh, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS, the Treasury Department, and the Bureau of Customs and Border Protection, Department of Homeland Security, participated in their development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 48 is proposed to be amended as follows:

PART 48 — MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. The authority citation for part 48 continues to read in part as follows:

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

Par. 2. In §48.4081-1, paragraph (b), the definition of *Enterer* is revised to read as follows:

§48.4081-1 Taxable fuel; definitions.

[The text of the proposed amendment to §48.4081-1(b) is the same as the text of §48.4081-1T(b), definition of *enterer*, published elsewhere in this issue of the Bulletin].

Par. 3. Section 48.4081-3 is amended by adding paragraphs (c)(2)(ii) through (c)(2)(iv) to read as follows:

§48.4081-3 Taxable fuel; taxable events other than removal at the terminal rack.

[The text of the proposed amendment to §48.4081-3(c)(2)(ii) through (iv) is the same as the text of §48.4081-3T(c)(2)(ii) through (iv) published elsewhere in this issue of the Bulletin].

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

(Filed by the Office of the Federal Register on July 29, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 30, 2004, 69 F.R. 45631)

Notice of Proposed Rulemaking

Real Estate Mortgage Investment Conduits

REG-154077-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the application of the unified partnership audit procedures to disputes regarding the ownership of residual interests in a Real Estate Mortgage Investment Conduit (REMIC). These regulations will affect taxpayers that invest in REMIC residual interests.

DATES: Written or electronically generated comments and requests for a public hearing must be received by November 1, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-154077-03), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-154077-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at: www.irs.gov/reg or the Federal eRulemaking Portal at www.regulations.gov (IRS - REG-154077-03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Arturo Estrada, (202) 622-3900 (not a toll-free number); concerning the submissions of comments, or a request for a public hearing, LaNita Van Dyke (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This proposed regulation amends 26 CFR Part 1 under section 860F of the

Internal Revenue Code (Code) relating to the application of the unified partnership audit procedures of subchapter C of chapter 63 of the Code to REMICs and the holders of residual interests. Section 860F(e) provides that a REMIC is treated as a partnership (and holders of residual interests in that REMIC shall be treated as partners) for purposes of subtitle F of the Code, which includes the unified partnership audit procedures. The taxable income of a holder of a REMIC residual interest is determined under the REMIC provisions of part IV of subchapter M, which require the holder to take into account its daily portion of the REMIC's taxable income or net loss for each day during the taxable year on which the holder holds its interest. Section 860C(a)(1). The provisions of subchapter K relating to the determination of the taxable income of a partnership and its partners do not apply to REMICs or the holders of REMIC residual interests. Section 860A(a).

Questions have arisen regarding whether the identity of the holder of a REMIC residual interest is treated as a partnership item for purposes of the unified partnership audit procedures. Questions also have arisen regarding the applicability of the unified partnership audit procedures when a determination is made under the REMIC regulations to disregard certain transfers of REMIC residual interests and continue to treat the transferor as the holder of the transferred REMIC residual interests. See §§1.860E-1(c) and 1.860G-3.

The IRS and Treasury Department have determined that the identity of a holder of a REMIC residual interest is more appropriately determined at the residual interest holder level than at the REMIC entity level.

Explanation of Provisions

The proposed regulations provide that the determination of the identity of a holder of a REMIC residual interest is not a partnership item for purposes of the unified partnership audit procedures as applied to REMICs, whether or not such determination involves the application of a disregarded transfer rule. Unlike the identity of a partner in a partnership subject to subchapter K, the identity of the holder of

a REMIC residual interest does not affect the calculation of the REMIC's taxable income or net loss.

Proposed dates of applicability

These regulations are proposed to apply after December 31, 1986. See §1.860A-1(b)(1)(ii).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection requirement on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal author of these regulations is Arturo Estrada, Office of the Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 860F-4 issued under 26 U.S.C. 860G(e) and 26 U.S.C. 6230(k).

Par. 2. In §1.860F-4, paragraph (a) is amended by adding a sentence at the end to read as follows:

§1.860F-4 REMIC reporting requirements and other administrative rules.

(a) *** The identity of a holder of a residual interest in a REMIC is not treated as a partnership item with respect to the REMIC for purposes of subchapter C of chapter 63.

Nancy J. Jardini,
*Acting Deputy Commissioner for
Services and Enforcement.*

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48431)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Time and Manner of Making §163(d)(4)(B) Election to Treat Qualified Dividend Income as Investment Income

REG-171386-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9147) relating to an election that may be made by noncorporate taxpayers to treat qualified dividend income as investment income for purposes of calculating the deduction for investment interest. The text of those temporary regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments and requests for a public hearing must be received by November 3, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-171386-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Alternatively, 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-171386-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. Taxpayers also may submit comments electronically to the IRS internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG-171386-03 or RIN 1545-BD16).

FOR FURTHER INFORMATION CONTACT: Concerning submission of comments or requesting a hearing, LaNita Van Dyke, (202) 622-7180; concerning the proposed regulations, Amy Pfalzgraf, (202) 622-4950 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR Part 1) relating to section 163(d)(4)(B) of the Internal Revenue Code. The temporary regulations provide rules regarding the time and manner for making an election under section 163(d)(4)(B) to treat qualified dividend income as investment income for purposes of calculating the deduction for investment interest. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Amy Pfalzgraf of the Office of Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.163(d)-1 is revised.

§1.163(d)-1 Time and manner for making elections under the Omnibus Budget Reconciliation Act of 1993 and the Jobs and Growth Tax Relief Reconciliation Act of 2003.

[The text of proposed paragraphs (a), (b), (c), and (d) is the same as the text of paragraphs (a), (b), (c), and (d) of §1.163(d)-1T published elsewhere in this issue of the Bulletin.]

Nancy J. Jardini,
*Acting Deputy Commissioner for
Services and Enforcement.*

(Filed by the Office of the Federal Register on August 4, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 5, 2004, 69 FR. 47395)

Notice of Proposed Rulemaking

Corporate Reorganizations; Guidance on the Measurement of Continuity of Interest

REG-129706-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the satisfaction of the continuity of interest requirement for corporate reorganizations. These proposed regulations affect corporations and their shareholders. This document also provides a notice of a public hearing on these proposed regulations.

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

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-129706-04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday

through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-129706-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-129706-04).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Christopher M. Bass, (202) 622-7770; concerning submissions and comments, concerning the hearing, Guy Traynor, (202) 622-7180 (not-toll free numbers).

SUPPLEMENTARY INFORMATION:

Background

The Internal Revenue Code of 1986 (Code) provides general nonrecognition treatment for reorganizations described in section 368 of the Code. In addition to complying with the statutory requirements and certain other requirements, to qualify as a reorganization, a transaction generally must satisfy the continuity of interest (COI) requirement.

Section 1.368-1(e) provides that the purpose of the COI requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. COI requires that, in substance, a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. A proprietary interest in the target corporation is preserved if, in a potential reorganization, it is exchanged for a proprietary interest in the issuing corporation, it is exchanged by the acquiring corporation for a direct interest in the target corporation enterprise, or it otherwise continues as a proprietary interest in the target corporation.

In a transaction in which the shareholders of the target corporation receive both money and acquiring corporation stock, commentators have expressed concern that the transaction could fail to satisfy the COI requirement as a result of a decline in the value of the acquiring corporation's stock between the date the parties agree to the terms of the transaction (the signing date) and the date the transaction closes. Commentators have noted that attempts to mitigate this concern have led to complexity in

structuring transactions intended to qualify as reorganizations. These proposed regulations provide guidance to help address those concerns.

Explanation of Provisions

The IRS and Treasury Department believe that there are certain cases in which the determination of whether the COI requirement is satisfied should be made by reference to the signing date value of the issuing corporation stock to be issued in the transaction. In these cases, the target corporation shareholders generally can be viewed as being subject to the economic fortunes of the issuing corporation as of the signing date. Therefore, these proposed regulations provide that in determining whether the COI requirement is satisfied, the consideration to be exchanged for the proprietary interests in the target corporation is valued as of the end of the last business day before the first date there is a binding contract to effect the potential reorganization, provided the consideration to be provided to the target corporation shareholders is fixed in such contract and includes only stock of the issuing corporation and money.

For this purpose, a binding contract is an instrument enforceable under applicable law against the parties to the instrument. The IRS and Treasury Department understand that tender offers are a frequent acquisition vehicle. Because the terms of a tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934 and the regulations promulgated thereunder are fixed in a manner similar to those of a binding contract, these proposed regulations provide that such a tender offer, even if not pursuant to a binding contract, will be treated as a binding contract for purposes of these regulations.

The proposed regulations provide that the presence of a condition outside the control of the parties shall not prevent an instrument from being a binding contract. For example, the fact that the completion of a tender offer is subject to a shareholder vote or the target shareholders tendering a sufficient amount of target stock will be considered a condition outside the control of the parties.

Finally, these proposed regulations provide that consideration is fixed if the contract states the exact number of shares

of the issuing corporation and the exact amount of money, if any, to be exchanged for the proprietary interests in the target corporation. However, where the consideration is comprised of only issuing corporation stock and money, variable consideration will be treated as fixed consideration if a target corporation shareholder has an election to receive stock and/or money in respect of target corporation stock and the minimum amount of issuing corporation stock and the maximum amount of money that the target shareholders might receive can be determined. For purposes of determining whether a transaction that involves such variable consideration satisfies the continuity of interest requirement, these proposed regulations assume the issuance of the minimum number of shares and the maximum amount of money allowable under the contract, without regard to the number of shares and amount of money actually exchanged for proprietary interests in the target corporation.

In the course of developing these regulations, the IRS and Treasury Department considered whether the rule provided in these proposed regulations should be applied in other cases and what presumptions or conventions would be necessary to assess whether the COI requirement has been satisfied in such other cases. The IRS and Treasury Department request comments in this regard.

This regulation is proposed to apply to transactions occurring pursuant to binding contracts entered into after the date these regulations are published as final regulations in the **Federal Register**.

Special Analyses

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

for comment on their impact on small businesses.

Comments and Requests for Public Hearing

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

Drafting Information

The principal author of these proposed regulations is Christopher M. Bass, Office of the Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

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Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.368-1 is amended by:

1. Redesignating paragraphs (e)(2) through (e)(7) as (e)(3) through (e)(8), respectively.
2. Adding new paragraph (e)(2).
3. Newly designated paragraph (e)(7) is further redesignated as (e)(7)(i) and *Examples 10, 11, and 12* are added.
4. Adding paragraph (e)(7)(ii).

The additions read as follows:

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

* * * * *

(e) * * *

(2) *Measuring continuity of interest*—(i) *In General*. In determining whether a proprietary interest in the target corporation is preserved, the consideration to be exchanged for the proprietary interests in the target corporation shall be valued as of the end of the last business day before the first date there is a binding contract to effect the potential reorganization, provided the consideration is fixed in such contract and includes only stock of the issuing corporation and money.

(ii) *Binding contract*—(A) *In general*. A binding contract is an instrument enforceable under applicable law against the parties to the instrument. The presence of a condition outside the control of the parties (including, for example, regulatory agency approval) shall not prevent an instrument from being a binding contract. Further, the fact that insubstantial terms remain to be negotiated by the parties to the contract, or that customary conditions remain to be satisfied, shall not prevent an instrument from being a binding contract. If a term of a binding contract that relates to the amount or type of the consideration the target shareholders will receive in a potential reorganization is modified before the closing date of the potential reorganization, and the contract as modified is a binding contract, the date of the modification shall be treated as the first date there is a binding contract.

(B) *Tender offers*. For purposes of this paragraph (e)(2), a tender offer that is subject to section 14(d) of the Securities and Exchange Act of 1934 [15 U.S.C. 78n(d)(1)] and Regulation 14D [17 CFR §§240.14d-1 through 240.14d-101] and is not pursuant to a binding contract, is treated as a binding contract made on the date of its announcement, notwithstanding that it may be modified by the offeror or that it is not enforceable against the offerees. If a modification of such a tender offer is subject to the provisions of Regulation 14d-6(c) [17 CFR §240.14d-6(c)] and relates to the amount or type of the consideration received in the tender offer, then the date of the modification shall be treated as the first date there is a binding contract.

(iii) *Fixed consideration*—(A) *In general*. Consideration is fixed in a contract if the contract states the number of shares of the issuing corporation and the amount of money, if any, to be exchanged for the

proprietary interests in the target corporation. Placing part of the stock issued or money paid in escrow to secure customary target representations and warranties will not prevent the consideration from being fixed.

(B) *Special rule for shareholder elections*. Notwithstanding the provisions of paragraph (e)(2)(iii)(A) of this section, consideration is also treated as fixed if a target corporation shareholder has an election to receive stock and/or money in respect of target corporation stock and the contract states the minimum number of shares of the issuing corporation and the maximum amount of money to be exchanged for the proprietary interests in the target corporation. In this case, the determination of whether a proprietary interest in the target corporation is preserved shall be made by assuming the issuance of the minimum number of shares and the maximum amount of money allowable under the contract and without regard to the number of shares and amount of money actually exchanged thereafter for proprietary interests in the target corporation.

(iv) *Effective date*. Paragraph (e)(2) applies to transactions occurring pursuant to binding contracts entered into after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

(7)(i) *Examples*. * * *

* * * * *

Example 10. Fixed consideration on signing date. On January 3 of Year 1, P and T sign a binding contract pursuant to which T will be merged with and into P on June 2 of Year 1. Pursuant to the contract, the T shareholders will receive 40 P shares and \$60 in exchange for all of the outstanding stock of T. Ten of the P shares, however, will be placed in escrow to secure customary target representations and warranties. At the end of the day on January 2 of Year 1, the P stock trades for \$1 per share. On June 1 of Year 1, the P stock trades for \$.25 per share. Under paragraph (e)(2) of this section, there is a binding contract with fixed consideration as of January 3 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock as of the end of the day on January 2 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$40 of P stock and \$60, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 11. Modification of binding contract. The facts are the same as in *Example 10*, except that on April 1 of Year 1, the parties modify their contract. Pursuant to the modified contract, which is a

binding contract, the T shareholders will receive 50 P shares and \$60 in exchange for all of the outstanding T stock. At the end of the day on March 31 of Year 1, the P stock trades for \$.80 per share. Under paragraph (e)(2) of this section, although there was a binding contract with fixed consideration as of January 3 of Year 1, terms of that contract relating to the consideration to be provided to the target shareholders were modified on April 1 of Year 1. Therefore, whether the transaction satisfies the continuity of interest requirement is determined by reference to the value of the P stock as of the end of the day on March 31 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$40 of P stock and \$60, the transaction preserves a substantial part of the value of the proprietary interest in T. Therefore, the transaction satisfies the continuity of interest requirement.

Example 12. The facts are the same as in *Example 11* except that, at the end of the day on March 31 of Year 1, the P stock trades for \$.51 per share. As in *Example 11*, whether the transaction satisfies COI is determined by reference to the value of the P stock as of the end of the day on March 31 of Year 1. Because, for continuity of interest purposes, the T stock is exchanged for \$25.50 of P stock and \$60, a substantial part of the value of the proprietary interest in T is not preserved. Therefore, the transaction does not satisfy the continuity of interest requirement.

(ii) *Effective date*. Paragraph (e)(7)(i) *Examples 10, 11, and 12* apply to transactions occurring pursuant to binding contracts entered into after the date these regulations are published as final regulations in the **Federal Register**.

* * * * *

Nancy J. Jardini,
Acting Deputy Commissioner for
Services and Enforcement.

(Filed by the Office of the Federal Register on August 9, 2004, 8:45 a.m., and published in the issue of the Federal Register for August 10, 2004, 69 F.R. 48429)

Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking

Source of Compensation for Labor or Personal Services

REG-208254-90;
REG-136481-04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking.

SUMMARY: This document contains new proposed rules that describe the proper basis for determining the source of compensation from labor or personal services performed partly within and partly without the United States. The new proposed rules will affect individuals that earn compensation from labor or personal services performed partly within and partly without the United States and are needed to provide appropriate guidance regarding the determination of the proper source of that compensation. This document also withdraws the notice of proposed rulemaking (REG-208254-90, 2000-1 C.B. 577) published in the **Federal Register** on January 21, 2000 (65 FR 3401).

DATES: Written or electronic comments and requests for a public hearing must be received by November 4, 2004. The notice of proposed rulemaking published on January 21, 2000, is withdrawn as of August 6, 2004.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-136481-04), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-136481-04), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC, or sent electronically via the IRS Internet site at: <http://www.irs.gov/regs> or Federal eRulemaking Portal at <http://www.regulations.gov> (IRS and REG-136481-04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Bergkuist, (202) 622-3850 (not a toll-free number); concerning the submissions of comments, LaNita Van Dyke (202) 622-7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)).

Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP Washington, DC 20224. Comments on the collection of information should be received by October 5, 2004. Comments are specifically requested concerning:

Whether the proposed collections of information are necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collections of information (see below);

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

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

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

The collections of information in this proposed regulation are in §1.861-4(b)(2)(ii)(C)(I)(i), (b)(2)(ii)(D), and (b)(2)(ii)(D)(6). The information required in §1.861-4(b)(2)(ii)(C)(I)(i) will enable an individual, where appropriate, to use an alternative basis other than that described in §1.861-4(b)(2)(ii)(A) or (B) to determine the source of his or her compensation as an employee for labor or personal services performed partly within and partly without the United States. The information required in §1.861-4(b)(2)(ii)(D) and (D)(6) will enable an employee to source certain fringe benefits on a geographical basis. The collections of information will, likewise, allow the IRS to verify these determinations.

The collections of information and responses to these collections of information are required to obtain and maintain benefits. The likely respondents are individuals who perform labor or personal services

partly within and partly without the United States, some of which may receive certain fringe benefit compensation for those services.

Estimated total annual recordkeeping burden: 10,000 hours.

The estimated annual burden per recordkeeper varies from 15 minutes to one hour, depending on the circumstances of the individual, with an estimated average of 30 minutes.

Estimated number of recordkeepers: 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 tax return information are confidential, as required by 26 U.S.C. 6103.

Background

This document contains proposed amendments (the new proposed regulations) 26 CFR part 1 under section 861 of the Internal Revenue Code (Code). On January 21, 2000, a notice of proposed rulemaking was published in the **Federal Register** at 65 FR 3401 [REG-208254-90, 2000-1 C.B. 577] (the previously proposed regulations). The previously proposed regulations would have modified the existing final regulations relating to the determination of the source of income from the performance of labor or personal services performed partly within and partly without the United States. Written comments were received in response to the notice of proposed rulemaking. A public hearing was held on July 18, 2000. In response to these comments, and after further consideration of the issue, the previously proposed regulations are withdrawn and new regulations are proposed. This preamble discusses comments received on the previously proposed regulations and describes the differences between the new proposed regulations and the previously proposed regulations.

Explanation of Provisions

The existing final regulations, §1.861-4(b), provide that if a person performs labor or personal services partly within and partly without the United States, the amount to be included in gross income from United States sources shall be determined on the basis that most correctly reflects the proper source of income under the facts and circumstances of the particular case.

The previously proposed regulations retained the facts and circumstances basis for determining the source of such income for persons other than individuals. For individuals, however, the previously proposed regulations provided that if an individual received compensation for a specific time period for labor or personal services that are performed partly within and partly without the United States, the amount of compensation for labor or personal services performed within the United States would have been determined solely on a time basis.

Several comments questioned the rule in the previously proposed regulations that required individuals to determine the source of such income on a time basis. In response to those comments, and after further consideration of the issues presented, the previously proposed regulations are withdrawn and new regulations are proposed that take into account the concerns raised.

Treasury and the IRS believe that a time basis generally is the most appropriate method for determining the source of an individual employee's compensation for labor and personal services performed partly within and partly without the United States. Compensation provided to an employee for a specific time period is generally considered to be earned by the employee ratably over that time period. Accordingly, it is appropriate generally to source such compensation on a ratable basis. In addition, Treasury and the IRS believe that this rule will provide certainty and simplification for both taxpayers and the IRS. The information necessary to apply the time basis should be readily available to employers and employees. For example, Form 2555, "Foreign Earned Income", requires an individual who claims the foreign earned income exclusion to provide the IRS with

information relating to the number of business days spent within the United States and any fringe benefits received. Sourcing on a time basis may be appropriate as well for individuals other than employees who receive compensation for labor or personal services and who may be viewed as earning such compensation ratably.

Nonetheless, for entities other than individuals and for individuals who are not employees, the facts and circumstances in many cases may be such that an apportionment on a basis other than a time basis may be more appropriate. For example, a corporation could receive payments under a contract for services to be performed by numerous employees at various pay levels in a number of different geographic locations. In such a case, payroll costs under the contract for services, or another basis besides time, may more correctly reflect the proper source of the corporation's income.

The new proposed regulations retain the facts and circumstances basis as the general rule for determining the source of compensation for labor and personal services performed partly within and partly without the United States received by persons other than individuals and by individuals who are not employees. However, the new proposed regulations provide two new general bases for determining the proper source of compensation that an individual receives as an employee for such labor or personal services. Under the first general basis of §1.861-4(b)(2)(ii)(A), an individual who receives compensation, other than compensation in the form of certain fringe benefits, as an employee for labor or personal services performed partly within and partly without the United States is required to source such compensation on a time basis, as defined in §1.861-4(b)(2)(ii)(E).

Under the second general basis of §1.861-4(b)(2)(ii)(B) and (D), an individual who receives compensation as an employee for labor or personal services performed partly within and partly without the United States in the form of fringe benefits, as described in §1.861-4(b)(2)(ii)(D)(I) through (6), is required to source such compensation on a geographical basis (e.g., at the employee's principal place of work, as defined in section 217 and §1.217-2(c)(3)). The fringe benefits to which this general basis applies are: hous-

ing, education, local transportation, tax reimbursement, hazardous or hardship duty pay, and moving expense reimbursement fringe benefits. This general basis will apply only if the amount of the fringe benefit is reasonable and is substantiated by adequate contemporaneous records or sufficient evidence under rules similar to those set forth in §1.274-5T(c) or (h) or §1.132-5, and only if the fringe benefit meets the definition set forth in the new proposed regulations. Treasury and the IRS intend to keep the list and descriptions of identified fringe benefits current and invite comments regarding whether the identified fringe benefits are appropriately defined and whether other fringe benefits should be identified in the regulations and sourced on a specific geographic basis.

Treasury and the IRS recognize that there are circumstances in which these two general bases may not be the most appropriate basis for determining the source of an employee's compensation for labor or personal services performed partly within and partly without the United States. Accordingly, the new proposed regulations at §1.861-4(b)(2)(ii)(C)(I)(i) provide that an employee may use an alternative basis, based upon the facts and circumstances, to source such compensation if he or she establishes to the satisfaction of the Commissioner that such an alternative basis more properly determines the source of the compensation. For example, when an employee's compensation is tied to the performance of specific actions rather than earned ratably over a specific time period, an alternative basis may more properly determine the source of compensation than the bases for determining source of compensation described in §1.861-4(b)(2)(ii)(A) and (B).

In order to satisfy the Commissioner, an employee must retain in his or her records documentation setting forth why the alternative basis more properly determines the source of the compensation than the basis for determining source of compensation described in §1.861-4(b)(2)(ii)(A) or (B). In addition, it is anticipated that the Commissioner, by ruling or other administrative pronouncement, will issue guidance as to what procedures an employee must follow in order to assert an alternative basis to determine the source of his or her compensation for labor or personal ser-

vices performed partly within and partly without the United States. Such administrative pronouncement will likely require that an individual who has \$250,000 or more in compensation for the tax year must indicate in the manner prescribed that he or she is using an alternative basis to source his or her compensation. Such individual may be required to file a form, or retain the following in his or her records: (1) a written explanation of why the alternative basis more properly determines the source of the compensation than the basis for determining source of compensation described in §1.861-4(b)(2)(ii)(A) or (B) under the facts and circumstances, and (2) a written comparison of the dollar amount of the compensation sourced within and without the United States under both the individual's alternative basis and the basis for determining source of compensation described in §1.861-4(b)(2)(ii)(A) or (B).

Section 1.861-4(b)(2)(ii)(C)(I)(ii) of the new proposed regulations also provides that the Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis other than a basis described in paragraph (b)(2)(ii)(A) or (B) if such compensation either (1) is not for a specific time period or (2) constitutes in substance a fringe benefit described in paragraph (b)(2)(ii)(D) notwithstanding a failure to meet any requirement of paragraph (b)(2)(ii)(D). The Commissioner may make this determination only if such alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual pursuant to paragraph (b)(2)(ii)(A) or (B).

Section 1.861-4(b)(2)(ii)(C)(2) of the new proposed regulations provides that the Commissioner may, by ruling or other administrative pronouncement applying to similarly situated taxpayers generally, permit individuals to determine the source of their compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis. Any such individual shall be treated as having met the requirement to establish such alternative basis to the satisfaction of the Commissioner under the facts and circumstances

of the particular case, provided that the individual meets the other requirements of paragraph (b)(2)(ii)(C)(I)(i). This paragraph also provides that the Commissioner may, by ruling or other administrative pronouncement, indicate the circumstances in which he will require individuals to determine the source of certain compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis pursuant to the authority under paragraph (b)(2)(ii)(C)(I)(ii) of this section.

Section 1.861-4(b)(2)(ii)(C)(3) of the new proposed regulations is reserved with respect to artists and athletes who are employees. It is intended that the specific rules for artists and athletes who are employees will require such individuals to determine the proper source of compensation for labor or personal services on the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case, consistent with current law. Comments are invited in this connection, including on the proper definition of an *artist* or *athlete* for this purpose.

Examples illustrating these new rules with respect to compensation that an individual receives as an employee are included in §1.861-4(b)(2)(ii)(G) of the new proposed regulations.

Several of the comments to the previously proposed regulations requested specific rules for compensation arrangements that relate to services performed over a period of more than one year, such as employee stock option plans, transfers of restricted property, and other deferred compensation arrangements. The new proposed regulations provide at §1.861-4(b)(2)(ii)(F) that the source of multi-year compensation of an employee is generally determined on a time basis over the applicable period to which the compensation is attributable. Determination of the applicable period to which the compensation is attributable (including whether the compensation relates to more than one taxable year) is based upon the facts and circumstances of the particular case. Treasury and the IRS invite taxpayers to provide comments on whether alternative bases for determining the source of such multi-year compensation are appropriate.

One comment questioned whether a day was the only time period upon which to apply the time basis of sourcing compensation. In response to this comment, the new proposed regulations provide at §1.861-4(b)(2)(ii)(E) that, although the time basis is generally determined by comparing the number of days of performance of the labor or personal services by the individual within the United States to his or her total number of days of performance of labor or personal services, use of a unit of time less than a day may be appropriate for purposes of this calculation. For example, it may be more appropriate to source compensation paid to an airline flight crewmember based on a time unit of less than a day.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these proposed regulations is David Bergkuist of the Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury participated in their development.

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Withdrawal of a Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking published in the **Federal Register** on January 21, 2000 (65 CFR 3401), REG-208254-90 is withdrawn.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.861-4 is amended as follows:

1. The heading for paragraph (a) is revised.
2. A sentence is added at the beginning of paragraph (a)(1).
3. Paragraph (b) is revised.
4. A sentence is added at the end of paragraph (d).

The revisions and addition read as follows:

§1.861-4 Compensation for labor or personal services.

(a) *Compensation for labor or personal services performed wholly within the United States*—(1) Generally, compensation for labor or personal services, including fees, commissions, fringe benefits, and similar items, performed wholly within the United States is gross income from sources within the United States.

* * *

(b) *Compensation for labor or personal services performed partly within and partly without the United States*—(1) *Compensation for labor or personal services performed by persons other than individuals*—(i) *In general.* In the case of

compensation for labor or personal services performed partly within and partly without the United States by a person other than an individual, the part of that compensation that is attributable to the labor or personal services performed within the United States, and that is therefore included in gross income as income from sources within the United States, is determined on the basis that most correctly reflects the proper source of the income under the facts and circumstances of the particular case. In many cases, the facts and circumstances will be such that an apportionment on the time basis, as defined in paragraph (b)(2)(ii)(E) of this section, will be acceptable.

(ii) *Example.* Corp X, a domestic corporation, receives compensation of \$150,000 under a contract for services to be performed concurrently in the United States and in several foreign countries by numerous Corp X employees. Each Corp X employee performing services under this contract performs his or her services exclusively in one jurisdiction. Although the number of employees (and hours spent by employees) performing services under the contract within the United States equals the number of employees (and hours spent by employees) performing services under the contract without the United States, the compensation paid to employees performing services under the contract within the United States is higher because of the more sophisticated nature of the services performed by the employees within the United States. Accordingly, the payroll cost for employees performing services under the contract within the United States is \$20,000 out of a total contract payroll cost of \$30,000. Under these facts and circumstances, a determination based upon relative payroll costs would be the basis that most correctly reflects the proper source of the income received under the contract. Thus, of the \$150,000 of compensation included in Corp X's gross income, \$100,000 ($\$150,000 \times \$20,000/\$30,000$) is attributable to the labor or personal services performed within the United States and \$50,000 ($\$150,000 \times \$10,000/\$30,000$) is attributable to the labor or personal services performed without the United States.

(2) *Compensation for labor or personal services performed by an individual*—(i) *In general.* Except as provided in paragraph (b)(2)(ii) of this section, in the case of compensation for labor or personal services performed partly within and partly without the United States by an individual, the part of such compensation that is attributable to the labor or personal services performed within the United States, and that is therefore included in gross income as income from sources within the United States, is determined on the basis that most correctly reflects the proper source of that income under the facts and circumstances of the particular case. In many cases, the

facts and circumstances will be such that an apportionment on a time basis, as defined in paragraph (b)(2)(ii)(E) of this section, will be acceptable.

(ii) *Employee compensation*—(A) *In general.* Except as provided in paragraph (b)(2)(ii)(B) or (C) of this section, in the case of compensation for labor or personal services performed partly within and partly without the United States by an individual as an employee, the part of such compensation that is attributable to the labor or personal services performed within the United States, and that is therefore included in gross income as income from sources within the United States, is determined on a time basis, as defined in paragraph (b)(2)(ii)(E) of this section.

(B) *Certain fringe benefits sourced on a geographical basis.* Except as provided in paragraph (b)(2)(ii)(C) of this section, items of compensation of an individual as an employee for labor or personal services performed partly within and partly without the United States that are described in paragraph (b)(2)(ii)(D)(1) through (6) of this section are sourced on a geographical basis in accordance with those paragraphs.

(C) *Exceptions and special rules*—(1) *Alternative basis*—(i) *Individual as an employee generally.* An individual may determine the source of his or her compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis if the individual establishes to the satisfaction of the Commissioner that, under the facts and circumstances of the particular case, the alternative basis more properly determines the source of the compensation than a basis described in paragraph (b)(2)(ii)(A) or (B), whichever is applicable, of this section. An individual that uses an alternative basis must retain in his or her records documentation setting forth why the alternative basis more properly determines the source of the compensation. In addition, the individual must comply with the requirements set forth in any applicable administrative pronouncement issued by the Commissioner.

(ii) *Determination by Commissioner.* The Commissioner may, under the facts and circumstances of the particular case, determine the source of compensation that is received by an individual as an employee for labor or personal services performed partly within and partly without

the United States under an alternative basis other than a basis described in paragraph (b)(2)(ii)(A) or (B) of this section if such compensation either is not for a specific time period or constitutes in substance a fringe benefit described in paragraph (b)(2)(ii)(D) of this section notwithstanding a failure to meet any requirement of paragraph (b)(2)(ii)(D) of this section. The Commissioner may make this determination only if such alternative basis determines the source of compensation in a more reasonable manner than the basis used by the individual pursuant to paragraph (b)(2)(ii)(A) or (B) of this section.

(2) *Ruling or other administrative pronouncement with respect to groups of taxpayers.* The Commissioner may, by ruling or other administrative pronouncement applying to similarly situated taxpayers generally, permit individuals to determine the source of their compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis. Any such individual shall be treated as having met the requirement to establish such alternative basis to the satisfaction of the Commissioner under the facts and circumstances of the particular case, provided that the individual meets the other requirements of paragraph (b)(2)(ii)(C)(1)(i) of this section. The Commissioner also may, by ruling or other administrative pronouncement, indicate the circumstances in which he will require individuals to determine the source of certain compensation as an employee for labor or personal services performed partly within and partly without the United States under an alternative basis pursuant to the authority under paragraph (b)(2)(ii)(C)(1)(ii) of this section.

(3) *Artists and athletes.* [RESERVED.]

(D) *Fringe benefits sourced on a geographical basis.* Except as provided in paragraph (b)(2)(ii)(C) of this section, compensation of an individual as an employee for labor or personal services performed partly within and partly without the United States in the form of the following fringe benefits is sourced on a geographical basis as indicated in this paragraph (b)(2)(ii)(D). The amount of the compensation in the form of the fringe benefit must be reasonable, and the individual must substantiate such amounts by adequate records or by sufficient evidence

under rules similar to those set forth in §1.274-5T(c) or (h) or §1.132-5. For purposes of this paragraph (b)(2)(ii)(D), the term *principal place of work* has the same meaning that it has for purposes of section 217 and §1.217-2(c)(3).

(1) *Housing fringe benefit.* The source of compensation in the form of a housing fringe benefit is determined based on the location of the individual's principal place of work. For purposes of this paragraph (b)(2)(ii)(D)(1), a housing fringe benefit includes payments to or on behalf of an individual (and the individual's family if the family resides with the individual) only for rent, utilities (other than telephone charges), real and personal property insurance, occupancy taxes not deductible under section 164 or 216(a), nonrefundable fees paid for securing a leasehold, rental of furniture and accessories, household repairs, residential parking, and the fair rental value of housing provided in kind by the individual's employer. A housing fringe benefit does not include payments for expenses or items set forth in §1.911-4(b)(2).

(2) *Education fringe benefit.* The source of compensation in the form of an education fringe benefit for the education expenses of the individual's dependents is determined based on the location of the individual's principal place of work. For purposes of this paragraph (b)(2)(ii)(D)(2), an education fringe benefit includes payments only for qualified tuition and related expenses of the type described in section 530(b)(4)(A)(i) and expenditures for room and board and uniforms as described in section 530(b)(4)(A)(ii) with respect to education at an elementary or secondary educational institution.

(3) *Local transportation fringe benefit.* The source of compensation in the form of a local transportation fringe benefit is determined based on the location of the individual's principal place of work. For purposes of this paragraph (b)(2)(ii)(D)(3), an individual's local transportation fringe benefit is the amount that the individual receives as compensation for local transportation of the individual or the individual's spouse or dependents at the location of the individual's principal place of work. The amount treated as a local transportation fringe benefit is limited to the actual expenses incurred for local transportation and the fair rental value of any vehicle pro-

vided by the employer and used predominantly by the individual or the individual's spouse or dependents for local transportation. For this purpose, actual expenses incurred for local transportation do not include the cost (including interest) of the purchase by the individual, or on behalf of the individual, of an automobile or other vehicle.

(4) *Tax reimbursement fringe benefit.* The source of compensation in the form of a foreign tax reimbursement fringe benefit is determined based on the location of the jurisdiction that imposed the tax for which the individual is reimbursed.

(5) *Hazardous or hardship duty pay fringe benefit.* The source of compensation in the form of a hazardous or hardship duty pay fringe benefit is determined based on the location of the hazardous or hardship duty zone for which the hazardous or hardship duty pay fringe benefit is paid. For purposes of this paragraph (b)(2)(ii)(D)(5), a hazardous or hardship duty zone is any place in a foreign country which is either designated by the Secretary of State as a place where living conditions are extraordinarily difficult, notably unhealthy, or where excessive physical hardships exist, and for which a post differential of 15 percent or more would be provided under section 5925(b) of Title 5 of the U.S. Code to any officer or employee of the U.S. Government present at that place, or where a civil insurrection, civil war, terrorism, or wartime conditions threatens physical harm or imminent danger to the health and well-being of the individual. Compensation provided an employee during the period that the employee performs labor or personal services in a hazardous or hardship duty zone may be treated as a hazardous or hardship duty pay fringe benefit only if the employer provides the hazardous or hardship duty pay fringe benefit only to employees performing labor or personal services in a hazardous or hardship duty zone. The amount of compensation treated as a hazardous or hardship duty pay fringe benefit may not exceed the maximum amount that the U. S. government would allow its officers or employees present at that location.

(6) *Moving expense reimbursement fringe benefit.* Except as otherwise provided in this paragraph (b)(2)(ii)(D)(6), the source of compensation in the form of a moving expense reimbursement is

determined based on the location of the employee's new principal place of work. The source of such compensation is determined based on the location of the employee's former principal place of work, however, if the individual provides sufficient evidence that such determination of source is more appropriate under the facts and circumstances of the particular case. For purposes of this paragraph (b)(2)(ii)(D)(6), sufficient evidence generally requires an agreement, between the employer and the employee, or a written statement of company policy, which is reduced to writing before the move and which is entered into or established to induce the employee or employees to move to another country. The writing must state that the employer will reimburse the employee for moving expenses that the employee incurs to return to the employee's former principal place of work regardless of whether he or she continues to work for the employer after returning to that location. The writing may contain certain conditions upon which the right to reimbursement is determined as long as those conditions set forth standards that are definitely ascertainable and can only be fulfilled prior to, or through completion of, the employee's return move to the employee's former principal place of work.

(E) *Time basis.* The amount of compensation for labor or personal services performed within the United States determined on a time basis is the amount that bears the same relation to the individual's total compensation as the number of days of performance of the labor or personal services by the individual within the United States bears to his or her total number of days of performance of labor or personal services. A unit of time less than a day may be appropriate for purposes of this calculation. The time period for which the compensation for labor or personal services is made is presumed to be the calendar year in which the labor or personal services are performed, unless the taxpayer establishes to the satisfaction of the Commissioner, or the Commissioner determines, that another distinct, separate, and continuous period of time is more appropriate. For example, a transfer during a year from a position in the United States to a foreign posting that lasted through the end of that year would generally establish two separate time periods within that taxable year. The first

of these time periods would be the portion of the year preceding the start of the foreign posting, and the second of these time periods would be the portion of the year following the start of the foreign posting. However, in the case of a foreign posting that requires short-term returns to the United States to perform services for the employer, such short-term returns would not be sufficient to establish distinct, separate, and continuous time periods within the foreign posting time period but would be relevant to the allocation of compensation relating to the overall time period. In each case, the source of the compensation on a time basis is based upon the number of days (or unit of time less than a day, if appropriate) in that separate time period.

(F) *Multi-year compensation arrangements.* The source of multi-year compensation is determined generally on a time basis, as defined in paragraph (b)(2)(ii)(E) of this section, over the period to which such compensation is attributable. For purposes of this paragraph (b)(2)(ii)(F), *multi-year compensation* means compensation that is included in the income of an individual in one taxable year but that is attributable to a period that includes two or more taxable years. The determination of the period to which such compensation is attributable, for purposes of determining its source, is based upon the facts and circumstances of the particular case. For example, an amount of compensation that specifically relates to a period of time that includes several calendar years is attributable to the entirety of that multi-year period. The amount of such compensation that is treated as from sources within the United States is the amount that bears the same relationship to the total multi-year compensation as the number of days (or unit of time less than a day, if appropriate) that labor or personal services were performed within the United States in connection with the project bears to the total number of days (or unit of time less than a day, if appropriate) that labor or personal services were performed in connection with the project. In the case of stock options, the facts and circumstances generally will be such that the applicable period to which the compensation is attributable is the period between the grant of an option and the date on which all employment-related conditions for its exercise have been satisfied (the vesting of the option).

(G) *Examples.* The following examples illustrate the application of this paragraph (b)(2)(ii):

Example 1. B, a nonresident alien individual, was employed by Corp M, a domestic corporation, from March 1 to December 25 of the taxable year, a total of 300 days, for which B received compensation in the amount of \$80,000. Under B's employment contract with Corp M, B was subject to call at all times by Corp M and was in a payment status on a 7-day week basis. Pursuant to that contract, B performed services (or was available to perform services) within the United States for 180 days and performed services (or was available to perform services) without the United States for 120 days. None of B's \$80,000 compensation was for fringe benefits as identified in paragraph (b)(2)(ii)(D) of this section. B determined the amount of compensation that is attributable to his labor or personal services performed within the United States on a time basis under paragraph (b)(2)(ii)(A) and (E) of this section. B did not assert, pursuant to paragraph (b)(2)(ii)(C)(1)(i) of this section, that, under the particular facts and circumstances, an alternative basis more properly determines the source of that compensation than the time basis. Therefore, B must include in income from sources within the United States \$48,000 ($\$80,000 \times 180/300$) of his compensation from Corporation M.

Example 2. (i) Same facts as in *Example 1* except that Corp M had a company-wide arrangement with its employees, including B, that they would receive an education fringe benefit, as described in paragraph (b)(2)(ii)(D)(2) of this section, while working in the United States. During the taxable year, B incurred education expenses for his dependent daughter that qualified for the education fringe benefit in the amount of \$10,000, for which B received a reimbursement from Corp M. B did not maintain adequate records or sufficient evidence of this fringe benefit as required by paragraph (b)(2)(ii)(D) of this section. When B filed his Federal income tax return for the taxable year, B did not apply paragraphs (b)(2)(ii)(B) and (D)(2) of this section to treat the compensation in the form of the education fringe benefit as income from sources within the United States, the location of his principal place of work during the 300-day period. Rather, B combined the \$10,000 reimbursement with his base compensation of \$80,000 and applied the time basis of paragraph (b)(2)(ii)(A) of this section to determine the source of his gross income.

(ii) On audit, B argues that because he failed to substantiate the education fringe benefit in accordance with paragraph (b)(2)(ii)(D) of this section, his entire employment compensation from Corp M is sourced on a time basis pursuant to paragraph (b)(2)(ii)(A) of this section. The Commissioner, after reviewing Corp M's fringe benefit arrangement, determines, pursuant to paragraph (b)(2)(ii)(C)(1)(ii) of this section, that the \$10,000 educational expense reimbursement constitutes in substance a fringe benefit described in paragraph (b)(2)(ii)(D)(2) of this section, notwithstanding a failure to meet all of the requirements of paragraph (b)(2)(ii)(D) of this section, and that an alternative geographic source basis, under the facts and circumstances of this particular case, is a more reasonable manner to determine the source of the compensation than the time basis used by B.

Example 3. (i) A, a United States citizen, is employed by Corp N, a domestic corporation. A's principal place of work is in the United States. A earns an annual salary of \$100,000. During the first quarter of the calendar year (which is also A's taxable year), A performed services entirely within the United States. At the beginning of the second quarter of the calendar year, A was transferred to Country X for the remainder of the year and received, in addition to her annual salary, \$30,000 in fringe benefits that are attributable to her new principal place of work in Country X. Corp N paid these fringe benefits separately from A's annual salary. Corp N supplied A with a statement detailing that \$25,000 of the fringe benefit was paid for housing, as defined in paragraph (b)(2)(ii)(D)(I) of this section, and \$5,000 of the fringe benefit was paid for local transportation, as defined in paragraph (b)(2)(ii)(D)(3) of this section. None of the local transportation fringe benefit is excluded from the employee's gross income as a qualified transportation fringe benefit under section 132(a)(5). Under A's employment contract, A was required to work on a 5-day week basis, Monday through Friday. During the last three quarters of the year, A performed services 30 days in the United States and 150 days in Country X and other foreign countries.

(ii) A determined the source of all of her compensation from Corp N pursuant to paragraph (b)(2)(ii)(A), (B), and (D)(I) and (3) of this section. A did not assert, pursuant to paragraph (b)(2)(ii)(C)(I)(i) of this section, that, under the particular facts and circumstances, an alternative basis more properly determines the source of that compensation than the bases set forth in paragraphs (b)(2)(ii)(A), (B), and (D)(I) and (3) of this section. However, in applying the time basis set forth in paragraph (b)(2)(ii)(E) of this section, A establishes to the satisfaction of the Commissioner that the first quarter of the calendar year and the last three quarters of the calendar year are two separate, distinct, and continuous periods of time. Accordingly, \$25,000 of A's annual salary is attributable to the first quarter of the year (25 percent of \$100,000). This amount is entirely compensation that was attributable to the labor or personal services performed within the United States and is, therefore, included in gross income as income from sources within the United States. The balance of A's compensation as an employee of Corp N, \$105,000 (which includes the \$30,000 in fringe benefits that are attributable to the location of A's principal place of work in Country X), is compensation attributable to the final three quarters of her taxable year. During those three quarters, A's periodic performance of services in the United States does not result in distinct, separate, and continuous periods of time. Of the \$75,000 paid for annual salary, \$12,500 ($30/180 \times \$75,000$) is compensation that was attributable to the labor or personal services performed within the United States and \$62,500 ($150/180 \times \$75,000$) is compensation that was attributable to the labor or personal services performed outside the United States. Pursuant to paragraphs (b)(2)(ii)(B) and (D)(I) and (3) of this section, A sourced the \$25,000 received for the housing fringe benefit and the \$5,000 received for the local transportation fringe benefit based on the location of her principal place of work, Country X. Accordingly, A included the \$30,000 in fringe benefits in her gross

income as income from sources without the United States.

Example 4. Same facts as in *Example 3*. Of the 150 days during which A performed services in Country X and in other foreign countries (during the final three quarters of A's taxable year), she performed 30 days of those services in Country Y. Country Y is a country designated by the Secretary of State as a place where living conditions are extremely difficult, notably unhealthy, or where excessive physical hardships exist and for which a post differential of 15 percent or more would be provided under section 5925(b) of Title 5 of the U.S. Code to any officer or employee of the U.S. government present at that place. Corp N has a policy of paying its employees a \$65 premium per day for each day worked in countries so designated. The \$65 premium per day does not exceed the maximum amount that the U.S. government would pay its officers or employees stationed in Country Y. Because A performed services in Country Y for 30 days, she earned additional compensation of \$1,950. The \$1,950 is considered a hazardous duty or hardship pay fringe benefit and is sourced under paragraphs (b)(2)(ii)(B) and (D)(5) of this section based on the location of the hazardous or hardship duty zone, Country Y. Accordingly, A included the amount of the hazardous duty or hardship pay fringe benefit (\$1,950) in her gross income as income from sources without the United States.

Example 5. (i) During 2006 and 2007, Corp P, a domestic corporation, employed four United States citizens, E, F, G, and H to work in its manufacturing plant in Country V. As part of his or her compensation package, each employee arranged for local transportation unrelated to Corp P's business needs. None of the local transportation fringe benefit is excluded from the employee's gross income as a qualified transportation fringe benefit under section 132(a)(5) and (f).

(ii) Under the terms of the compensation package that E negotiated with Corp P, Corp P permitted E to use an automobile owned by Corp P. In addition, Corp P agreed to reimburse E for all expenses incurred by E in maintaining and operating the automobile, including gas and parking. Provided that the local transportation fringe benefit meets the requirements of paragraph (b)(2)(ii)(D)(3) of this section, E's compensation with respect to the fair rental value of the automobile and reimbursement for the expenses E incurred is sourced under paragraphs (b)(2)(ii)(B) and (D)(3) of this section based on E's principal place of work in Country V. Thus, the local transportation fringe benefit will be included in E's gross income as income from sources without the United States.

(iii) Under the terms of the compensation package that F negotiated with Corp P, Corp P let F use an automobile owned by Corp P. However, Corp P did not agree to reimburse F for any expenses incurred by F in maintaining and operating the automobile. Provided that the local transportation fringe benefit meets the requirements of paragraph (b)(2)(ii)(D)(3) of this section, F's compensation with respect to the fair rental value of the automobile is sourced under paragraphs (b)(2)(ii)(B) and (D)(3) of this section based on F's principal place of work in Country V. Thus, the local transportation fringe benefit will be included in

F's gross income as income from sources without the United States.

(iv) Under the terms of the compensation package that G negotiated with Corp P, Corp P agreed to reimburse G for the purchase price of an automobile that G purchased in Country V. Corp P did not agree to reimburse G for any expenses incurred by G in maintaining and operating the automobile. Because the cost to purchase an automobile is not a local transportation fringe benefit as defined in paragraph (b)(2)(ii)(D)(3) of this section, the source of the compensation to G will be determined pursuant to paragraph (b)(2)(ii)(A) or (C) of this section.

(v) Under the terms of the compensation package that H negotiated with Corp P, Corp P agreed to reimburse H for the expenses that H incurred in maintaining and operating an automobile, including gas and parking, which H purchased in Country V. Provided that the local transportation fringe benefit meets the requirements of paragraph (b)(2)(ii)(D)(3) of this section, H's compensation with respect to the reimbursement for the expenses H incurred is sourced under paragraphs (b)(2)(ii)(B) and (D)(3) of this section based on H's principal place of work in Country V. Thus, the local transportation fringe benefit will be included in H's gross income as income from sources without the United States.

Example 6. (i) On January 1, 2006, Company Q compensates employee J with a grant of options to which section 421 does not apply that do not have a readily ascertainable fair market value when granted. The stock options permit J to purchase 100 shares of Company Q stock for \$5 per share. The stock options do not become exercisable unless and until J performs services for Company Q (or a related company) for 5 years. J works for Company Q for the 5 years required by the stock option grant. In years 2006–08, J performs all of his services for Company Q within the United States. In 2009, J performs 1/2 of his services for Company Q within the United States and 1/2 of his services for Company Q without the United States. In year 2010, J performs his services entirely without the United States. On December 31, 2012, J exercises the options when the stock is worth \$10 per share. J recognizes \$500 in taxable compensation ($(\$10 - \$5) \times 100$) in 2012.

(ii) Under the facts and circumstances, the applicable period is the 5-year period between the date of grant (January 1, 2006) and the date the stock options become exercisable (December 31, 2010). On the date the stock options become exercisable, J performs all services necessary to obtain the compensation from Company Q. Accordingly, the services performed after the date the stock options become exercisable are not taken into account in sourcing the compensation from the stock options. Therefore, pursuant to paragraph (b)(2)(ii)(A), since J performs 3 1/2 years of services for Company Q within the United States and 1 1/2 years of services for Company Q without the United States during the 5-year period, 7/10 of the \$500 of compensation (or \$350) recognized in 2012 is income from sources within the United States and the remaining 3/10 of the compensation (or \$150) is income from sources without the United States.

(d) *Effective date.* *** The first sentence of §1.861-4(a)(1) and §1.861-4(b)

apply to taxable years beginning on or after publication of the Treasury Decision adopting these rules as final regulations in the **Federal Register**.

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

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Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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

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

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

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