Internal Revenue
bulletin

Bulletin No. 2006-27
July 3, 2006

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.

SPECIAL ANNOUNCEMENT

Announcement 2006–43, page 48.

This announcement renews the Tax Exempt Bond (TEB) Mediation Pilot Program set forth in Announcement 2003–36, 2003–1 C.B. 1093, for an additional one-year period beginning on July 3, 2006.

INCOME TAX

T.D. 9265, page 1.
REG–112994–06, page 47.

Temporary and proposed regulations under section 7874(a)(2)(B) of the Code provide rules for determining whether a foreign corporation is a surrogate foreign corporation. Specifically, the regulations explain when there is an indirect acquisition of a domestic corporation's properties for purposes of section 7874(a)(2)(B). The regulations provide guidance for determining when the expanded affiliated group has substantial business activities in a foreign country for purposes of section 7874(a)(2)(B)(iii). In addition, the regulations include a rule that in certain situations, a publicly traded partnership may be treated as a surrogate foreign corporation. The regulations also provide rules for the treatment of options of the surrogate foreign corporation for purposes of section 7874(a)(2)(B)(ii). A public hearing on the proposed regulations is scheduled for October 24, 2006.

REG–135866–02, page 34.

Proposed regulations under sections 367 and 1248 of the Code set forth principles for the attribution of earnings and profits to shares of stock of current or former controlled foreign corporations that participate in certain nonrecognition transactions. The regulations also provide that, for purposes of section 1248, when a foreign partnership sells stock of a corporation, the partners of the partnership are treated as selling their proportionate shares of such stock.

ADMINISTRATIVE

Notice 2006–57, page 13.

This notice postpones until October 16, 2006, the due date for filing Form 8898, *Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession*, for tax years 2001 through 2005.

Rev. Proc. 2006–29, page 13.

This procedure contains revisions to Publication 1239, *Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically or Magnetically*. Rev. Proc. 2005–41 superseded.

Rev. Proc. 2006–31, page 32.

This procedure provides guidance on revoking an election under section 83(b) of the Code. The procedure sets forth the requirements that must be satisfied before permission to revoke the election can be granted. Additionally, it sets forth the information that must be provided when requesting permission to revoke an election under section 83(b).

Announcement 2006–42, page 48.

This document provides notice of a public hearing on proposed regulations (REG–146459–05, 2006–8 I.R.B. 504) under sections 402(g), 402A, 403(b), and 408A of the Code relating to designated Roth accounts. A public hearing is scheduled for July 26, 2006.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

Announcement 2006–43, page 48.
This announcement renews the Tax Exempt Bond (TEB) Mediation Pilot Program set forth in Announcement 2003–36, 2003–1 C.B. 1093, for an additional one-year period beginning on July 3, 2006.

Announcement 2006–44, page 49.
This document contains a correction to final regulations (T.D. 9254, 2006–13 I.R.B. 662) that apply when a member of a consolidated group transfers subsidiary stock at a loss. They also apply when a member holds loss shares of subsidiary stock and the subsidiary ceases to be a member of the group.

The IRS Mission

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Place missing child here.

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

Section 7874.—Rules Relating to Expatriated Entities and Their Foreign Parents

26 CFR 1.7874–2T: Surrogate foreign corporation (temporary).

T.D. 9265

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Guidance Under Section 7874 Regarding Expatriated Entities and Their Foreign Parents

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations under section 7874 of the Internal Revenue Code (Code) relating to the determination of whether a foreign entity shall be treated as a surrogate foreign corporation under section 7874(a)(2)(B) of the Code. The text of these temporary regulations also serves as the text of the proposed regulations (REG–112994–06) set forth in the notice of proposed rulemaking on this subject published elsewhere in this issue of the Bulletin.

DATES: *Effective Dates:* These regulations are effective June 6, 2006.

Applicability Date: For dates of applicability, see §1.7874–2T(j).

FOR FURTHER INFORMATION CONTACT: Milton Cahn, 202–622–3860 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

A. *Section 7874 — Overview*

This document contains temporary amendments to 26 CFR part 1 under section 7874 of the Internal Revenue Code (Code). Section 7874 provides rules for expatriated entities and their surrogate foreign corporations. An expatriated entity is defined in section 7874(a)(2)(A) as a domestic corporation or partnership with respect to which a foreign corporation is a surrogate foreign corporation, and also as any U.S. person related (within the meaning of section 267(b) or 707(b)(1)) to such domestic corporation or partnership.

A foreign corporation is treated as a surrogate foreign corporation under section 7874(a)(2)(B), if, pursuant to a plan or a series of related transactions: (i) the foreign corporation directly or indirectly acquires substantially all the properties held directly or indirectly by a domestic corporation, or substantially all the properties constituting a trade or business of a domestic partnership; (ii) after the acquisition at least 60 percent of the stock (by vote or value) of the foreign corporation is held by (in the case of an acquisition with respect to a domestic corporation) former shareholders of the domestic corporation by reason of holding stock in the domestic corporation, or (in the case of an acquisition with respect to a domestic partnership) by former partners of the domestic partnership by reason of holding a capital or profits interest in the domestic partnership (ownership percentage test); and (iii) the expanded affiliated group that includes the foreign corporation (EAG) does not have business activities in the foreign country in which the foreign corporation was created or organized that are substantial when compared to the total business activities of the EAG. Section 7874(c)(1) defines the term *expanded affiliated group* as an affiliated group defined in section 1504(a) but without regard to the exclusion of foreign corporations in section 1504(b)(3) and with a reduction of the 80 percent ownership threshold of section 1504(a) to a more-than-50 percent ownership threshold.

The tax treatment of expatriated entities and surrogate foreign corporations varies depending on the level of owner continuity. If the percentage of stock (by vote or value) in the surrogate foreign corporation held by former owners of the domestic entity, by reason of holding an interest in the domestic entity, is 80 percent or more, the surrogate foreign corporation is treated as a domestic corporation for all purposes of the Code. If such ownership percentage is 60 percent or more (but less than 80 percent), the surrogate foreign corporation is treated as a foreign corporation but certain income or gain required to be recognized by the expatriated entity under section 304, 311(b), 367, 1001, or any other applicable provision with respect to the transfer of property (other than inventory or similar property) or the license of property cannot be offset by net operating losses or credits (other than credits allowed under section 901). These measures generally apply from the first date properties are acquired pursuant to the plan through the end of the 10-year period following the completion of the acquisition.

Section 7874(c)(4) provides that transfers of properties or liabilities (including by contribution or distribution) are disregarded if such transfers are part of a plan a principal purpose of which is to avoid the purposes of the section.

The IRS and Treasury Department have broad authority to issue regulations under section 7874. Section 7874(c)(6) authorizes the Secretary of the Treasury to prescribe such regulations as may be appropriate to determine whether a corporation is a surrogate foreign corporation, including regulations to treat warrants, options, contracts to acquire stock, convertible debt interests, and other similar interests as stock, and to treat stock as not stock. In addition, under section 7874(g) the Secretary of the Treasury is authorized to provide regulations needed to carry out the section. Those regulations could include guidance providing adjustments to the application of the section as are necessary to prevent the avoidance of the section, including avoidance through the use of related persons, pass-through or other non-corporate entities, or other intermediaries.

The legislative history of section 7874 indicates that the section was intended to apply to so-called inversion transactions in which a U.S. parent corporation of a multinational corporate group is replaced by a foreign entity. See H.R. Conf. Rep.

No. 108–755, 108th Cong., 2d Sess., at 568 (Oct. 7, 2004). The Senate Finance Committee stated its belief "that inversion transactions resulting in a minimal presence in a foreign country of incorporation are a means of avoiding U.S. tax and should be curtailed." S. Rep. No. 108–192, 108th Cong., 1st Sess., at 142 (Nov. 7, 2003). In particular, Congress believed that such transactions permit corporations and other entities to continue to conduct business in the same manner as they did prior to the inversion, but with the result that the group that includes the inverted entity avoids U.S. tax on foreign operations and may engage in earnings-stripping techniques to avoid U.S. tax on U.S. operations. See S. Rep. No. 108–192, at 142 (Nov. 7, 2003); see also Joint Committee on Taxation, General Explanation of Tax Legislation Enacted in the 108th Congress, at 343 (May 2005).

The IRS and Treasury Department have issued temporary and proposed regulations under section 7874 relating to the application of section 7874(c)(2) (affiliated-owned stock rule), under which stock held by members of the expanded affiliate group that includes the acquiring foreign corporation (EAG) is not taken into account for purposes of the ownership percentage test of section 7874(a)(2)(B)(ii). See T.D. 9238, 2006–6 I.R.B. 408 (Feb. 6, 2006). Those regulations ensure that the affiliated-owned stock rule cannot be used to avoid the application of section 7874, through the use of hook stock or otherwise, to situations where that provision should apply. In addition, those regulations ensure that this test does not apply to certain transactions that are properly viewed as outside the scope of section 7874.

B. *Temporary and Proposed Regulations*

The temporary and proposed regulations provide guidance on the determination of whether a foreign entity is treated as a surrogate foreign corporation under section 7874(a)(2)(B) of the Code. In particular, the regulations address the indirect acquisition of properties, stock held by reason of holding an interest in a domestic entity, the substantial business activities of an EAG, prevention of the avoidance of section 7874 in certain circumstances, and certain effects of being treated as a domestic corporation under section 7874(b).

1. *Indirect acquisition of properties*

Section 7874 does not apply unless a foreign entity completes a direct or indirect acquisition of defined properties. The legislative history of the section indicates that Congress intended the acquisition of stock in a corporation to be considered an indirect acquisition of the properties held directly or indirectly by the corporation. See H.R. Conf. Rep. No. 108–755, 108th Cong., 2d Sess., at 573 (Oct. 7, 2004) ("U.S. corporation becomes a subsidiary of a foreign incorporated entity or otherwise transfers substantially all of its properties"). The IRS and Treasury Department believe that guidance regarding the indirect acquisition of properties held directly or indirectly by a domestic corporation is needed to refine further the parameters of the provision's scope.

The statute also applies to indirect acquisitions of properties constituting a trade or business of a domestic partnership. The IRS and Treasury Department are considering guidance regarding the application of this part of the statute, but are not issuing any such guidance at this time.

2. *Stock held by reason of holding an interest in the domestic entity*

Section 7874 requires a determination of the amount of stock in the acquiring foreign entity that is held by former shareholders or partners of the domestic corporation or partnership "by reason of" their holding stock or a partnership interest in the domestic entity. The IRS and Treasury Department believe that guidance is needed as to how this determination is made in certain circumstances.

3. *Substantial business activities of the EAG*

Section 7874 does not apply if the EAG has business activities in the foreign country in which, or under the laws of which, the acquiring foreign entity was created or organized that are substantial when compared to the total business activities of the EAG. The IRS and Treasury Department believe that Congress was concerned about transactions where the new foreign parent entity is incorporated in a country in which the EAG does not have a *bona fide* business presence that is meaningful in the context of the group's overall business. See S. Rep. No. 108–192, 108th Cong., 2d Sess., at 142 (Nov. 7, 2003) (The Committee believes that inversion transactions resulting in minimal presence in a foreign country of incorporation are a means of avoiding U.S. tax and should be curtailed.). The IRS and Treasury Department believe that guidance is necessary to ensure proper application of the substantial-business-activities rule.

4. *Preventing avoidance of the purposes of the section*

(i). *Publicly traded foreign partnership as acquiring entity*

The IRS and Treasury Department are aware of recent transactions in which taxpayers have attempted to avoid the application of section 7874 through the use of a foreign partnership. These transactions involve the acquisition of substantially all the properties of a domestic corporation or partnership by a foreign entity that is considered a foreign partnership for U.S. Federal income tax purposes, despite the fact that interests in the entity are (or will be) publicly traded on a securities exchange. Although a partnership is a flow-through entity for Federal income tax purposes, the substitution of a foreign partnership for a domestic corporation as the parent entity of a multinational group can create many of the same opportunities for U.S. tax avoidance that Congress sought to curtail by enacting section 7874 (namely, removal of foreign operations from U.S. taxing jurisdiction and the use of earnings-stripping techniques to reduce U.S. tax on income from domestic operations). Section 7874(g) is intended to provide authority to address these types of issues.

Under section 7704 of the Code, a publicly traded partnership is generally treated as a corporation for all purposes of the Code. Section 7704(c), however, generally provides an exception from corporate treatment if 90 percent or more of the partnership's gross income for a taxable year consists of passive income such as dividends. This exception does not apply on a look-through basis in the case of payments from related parties, so the exception can be satisfied even if the underlying earnings from which the income is

paid are not passive in nature. The legislative history of section 7704 indicates that the rationale for this exception was to preserve flow-through tax treatment where a partnership simply holds investments that the partners could have independently acquired, as opposed to business activities that would normally be conducted in corporate form and taxed at the entity level. See H.R. Rep. 100–391 (Oct. 26, 1987) at 1066–1067. In the case of a foreign eligible entity that acquires directly or indirectly substantially all the properties of a domestic corporation, or substantially all the properties constituting a trade or business of a domestic partnership, the rationale for the exception provided by section 7704(c) does not clearly apply.

The IRS and Treasury Department believe it is appropriate to exercise their regulatory authority under section 7874(g) to make adjustments to the application of the section to prevent avoidance of the purpose of the section through the use of certain non-corporate entities. In the absence of regulations making a relevant adjustment to the application of the section, a publicly traded foreign partnership that is not treated as a corporation under section 7704 arguably might not be treated as a surrogate foreign corporation under section 7874(a)(2)(B) on the grounds that the entity is considered a partnership rather than a corporation for Federal income tax purposes. The IRS and Treasury Department believe that it is contrary to the broad anti-abuse purposes of section 7874 for the provisions to be avoided in circumstances raising the same type of earnings stripping and other concerns simply by substituting a partnership for a corporation as the acquiring entity (often through the ease of a check the box election). To ensure that the purposes of section 7874 are not avoided in this manner, the regulations provide that a publicly traded foreign partnership that is not treated as a corporation under section 7704 will be treated as a foreign corporation for purposes of applying section 7874(a)(2)(B) to determine whether the acquiring foreign entity is a surrogate foreign corporation.

(ii). *Options and similar interests*

The IRS and Treasury Department are also concerned that taxpayers may attempt to avoid the purposes of section 7874 through the use of options and similar interests related to stock of the foreign acquirer. Congress foresaw the possibility of this type of avoidance and provided a specific grant of regulatory authority in this regard in section 7874(c)(6). The IRS and Treasury Department believe it is appropriate to exercise that authority at this time.

5. *Effects of section 7874(b)*

Under section 7874(b), a foreign corporation is treated for purposes of the Code as a domestic corporation if it would be a surrogate foreign corporation if the continuing ownership threshold of section 7874(a)(2)(B)(ii) were 80 percent rather than 60 percent. This "domestication" rule gives rise to certain issues relating to the application of other provisions of the Code. The IRS and Treasury Department believe that guidance on these issues is necessary to avoid uncertainty.

Explanation of Provisions

A. *Indirect Acquisition of Properties Held by a Domestic Corporation*

Commentators requested that specific guidance be provided regarding the application of section 7874 to acquisitions of stock, to clarify that such acquisitions are indirect acquisitions of the properties held by the corporation whose stock is acquired.

To this end, section 1.7874–2T(b) of the regulations provides that, for purposes of section 7874(a)(2)(B)(i), an acquisition by a foreign corporation of stock in a domestic corporation is considered to be an indirect acquisition of a proportionate amount of the properties held directly or indirectly by the domestic corporation. Further, the regulations provide that an acquisition by a foreign corporation of an interest in a partnership that holds stock in a domestic corporation is considered an indirect acquisition of a proportionate amount of the properties held directly or indirectly by the domestic corporation.

The regulations also provide that a foreign corporation's acquisition of stock in a second foreign corporation is not considered an indirect acquisition by the first foreign corporation of any properties held by a domestic corporation or domestic partnership owned wholly or partly by the second foreign corporation. The IRS and Treasury Department believe that it was not Congress's intent for section 7874 to apply to indirect acquisitions by foreign corporations of domestic entities that were already owned by a foreign corporation before the acquisition. See H.R. Conf. Rep. No. 108–755, 108th Cong., 2d Sess., at 568 (Oct. 7, 2004).

Finally, the regulations provide that, in acquisitions in which a corporation (either domestic or foreign) which is under the control of a foreign corporation acquires the stock or assets of a domestic corporation in exchange for stock of the controlling foreign corporation, such foreign corporation will be considered to have made the acquisition of a proportionate amount of the domestic corporation's stock or assets.

B. *Stock Held by Reason of Holding an Interest in the Domestic Entity*

Section 1.7874–2T(c) of the regulations provides that, for purposes of section 7874(a)(2)(B)(ii), stock of the acquiring foreign entity that is received in exchange for stock of a domestic corporation, or in exchange for a capital or profits interest in a domestic partnership, is considered to be stock held by reason of holding stock in the domestic corporation or holding the interest in the domestic partnership, as the case may be. Moreover, the regulations provide that, where, in the same transaction or series of related transactions, other property is also contributed to the foreign entity in exchange for its stock, the amount of stock held by a former shareholder of the domestic corporation or former partner of the domestic partnership for section 7874 purposes is determined on the basis of the relative value of the property in exchange for which the foreign entity's stock was issued. This rule is subject to the potential application of section 7874(c)(4), which requires that transfers be disregarded if they occur as part of a plan to avoid the purposes of section 7874.

The regulations also provide, for purposes of clarity, that the terms *former shareholders* and *former partners* mean any persons who held an ownership interest in the domestic entity before the acquisition, regardless of whether they continue to hold such an interest in the domestic entity after the acquisition.

C. *Substantial Business Activities in the Foreign Country of Incorporation*

The regulations provide both an all-facts-and-circumstances test and a bright-line safe harbor test of whether an EAG has substantial business activities in the acquiring foreign entity's country of incorporation when compared to the total business activities of the EAG. The IRS and Treasury Department believe that this dual approach appropriately provides taxpayers with the certainty of an objective and clear safe harbor, while preserving the ability of a taxpayer to conclude, in a case that is not within the scope of the safe harbor, that section 7874 is not applicable to a foreign entity's acquisition of the stock or assets of a domestic entity where, after the acquisition, the group has a meaningful and *bona fide* business presence in the relevant foreign country. This dual approach was also recommended by a commentator.

1. *Facts and circumstances test*

Section 1.7874–2T(d)(1) of the regulations provides, as a general rule, that the determination of whether the EAG has substantial business activities in the relevant foreign country, when compared to the total business activities of the EAG, will be based on an analysis of all the facts and circumstances of each case. The regulations set forth a non-exclusive list of factors to be considered in the analysis. The weight given to any factor will depend on the particular circumstances. The listed factors include, among other factors, the EAG's local employee headcount and payroll, property, and sales; the EAG's historical presence in the foreign country; its management activities in the country; and the strategic importance to the EAG as a whole of the business activities in that country.

The regulations state that the presence or absence of any factor, or any particular number of factors, in the list is not determinative, and that there is no minimum percentage of the group's total employee headcount, payroll, assets, or sales that must be shown to be in the foreign country. Nevertheless, the determination of substantiality for this purpose must be made on the basis of a comparison to the total activities of the EAG, and the factors in the list must be evaluated accordingly.

Congress intended to prevent taxpayers from avoiding section 7874 through tax-motivated transfers of properties or liabilities, by providing in section 7874(c)(4) that such transfers shall be disregarded. Therefore, in analyzing the facts and circumstances to determine whether an EAG's business activities in the relevant foreign country are substantial within the meaning of the statute, it is necessary to disregard any assets, liabilities or activities in the foreign country that were transferred pursuant to a plan a principal purpose of which was to avoid section 7874.

The regulations also provide that certain factors are not to be given weight in making the determination under the facts and circumstances test. These factors include any assets that are temporarily located in the foreign country for the purpose of avoiding the purposes of section 7874.

Although the list of factors to be disregarded does not include passive assets, the IRS and Treasury Department believe that the statutory phrase "business activities" ordinarily does not include passive investment activities and related income and assets. Investment assets may include intangible assets that have significant value but are not being exploited by any member of the EAG in the course of active business activities. In contrast, intangibles that are used in the course of active business operations by EAG members will normally be accorded due weight by the IRS in the application of the all-facts-and-circumstances test. In order to preserve a wide breadth for the all-facts-and-circumstances rule, investment assets and income have not been included in the list of factors to be given no weight, but it is expected that such passive assets and income normally would not be given any significant weight.

2. *Safe harbor test*

Section 1.7874–2T(d)(2) of the regulations sets forth an alternative, safe harbor test for determining whether, after the acquisition, an EAG has substantial business activities in the relevant foreign country, when compared to the total business activities of the EAG. The safe harbor test will only be satisfied by an EAG that has a substantial and *bona fide* business presence in the relevant foreign country. The IRS and Treasury Department intend, however, that even if the EAG does not satisfy the safe harbor test, it still may satisfy the facts and circumstances test of §1.7874–2T(d)(1). This safe harbor test is consistent with the approach suggested by a commentator.

The safe harbor test is satisfied if the EAG satisfies three conditions, relating to employees, assets, and sales. Under section 7874, the determination of whether an EAG's business activities in the relevant foreign country are substantial when compared to the total business activities of the EAG is to be made "after the acquisition." Given the practical difficulty of measuring the various business factors on dates other than the periodic dates during the year as of which an EAG's management accounts are prepared, the regulations provide for the determination of group employees, assets, and sales during a twelve month testing period ending on the last day of the monthly or quarterly accounting period in which the completion of the acquisition occurs. Moreover, the determination of facts existing on that day for purposes of the safe harbor rule is subject to the application of section 7874(c)(4), under which any transfer is disregarded if made pursuant to a plan a principal purpose of which is to avoid the purposes of section 7874.

The first condition of the safe harbor rule is that, after the acquisition, the group employees based in the foreign country account for at least 10 percent (by headcount and compensation) of total group employees.

The term *group employee* is defined as a common law employee of one or more group members on a full time basis throughout the twelve-month testing period. An employee is considered to be based in a country only if the employee spent more time providing services in such country than in any other country throughout such twelve-month period.

The second condition is that, after the acquisition, the total value of the group assets located in the foreign country represents at least 10 percent of the total value of all group assets.

The term *group assets* is defined as tangible property used or held for use in the active conduct of a trade or business by a group member. An item of tangible personal property is considered to be located in a country only if such item was physically present in such country for more

time than in any other country during the twelve-month testing period. Value is determined on a gross basis (that is, without reduction for liabilities) after the acquisition. Group assets acquired or transferred as part of a plan a principal purpose of which is to avoid the application of section 7874 are disregarded.

The IRS and Treasury Department specifically excluded intangible assets from the definition of group assets, even though intangibles may be used in the course of active business operations. The reason for excluding intangibles is that they frequently present difficult factual issues relating to their use, value, and location. Therefore, their inclusion in the definition of group assets for purposes of the safe harbor test would introduce a significant element of uncertainty in many cases as to the application of the safe harbor rule. Given that the purpose of the safe harbor rule is to provide a clear, bright-line test, it was decided that the definition of group assets should not include intangibles. This exclusion was also suggested by a commentator.

The third condition of the safe harbor rule is that, during the twelve-month testing period, the group sales made in the foreign country accounted for at least 10 percent of total group sales.

The term *group sales* is defined as sales by group members, measured by gross receipts from such sales. Group sales are considered to be made in a particular country only if the services, goods or other property transferred by those sales are sold for use, consumption or disposition in that country. The term "sales" includes sales of services and of the use of property as well as sales involving the transfer of title to personal property.

Consideration was given to the use of thresholds higher than the 10 percent figure used in the safe harbor rule. However, based on comments received, the IRS and Treasury Department believe that 10 percent is a reasonable threshold.

D. *Prevention of Avoidance of Section 7874*

1. *Acquisitions by publicly traded foreign partnerships*

It has been brought to the attention of the IRS and Treasury Department that taxpayers are implementing structures (including partnership structures) that result in many of the same overall tax consequences as structures that Congress intended to be subject to section 7874, but are taking the position that these structures are not within the scope of section 7874. As a result, the IRS and Treasury Department have identified acquisitions by certain publicly traded foreign partnerships as a category of transactions requiring a special rule in order to prevent avoidance of the purposes of section 7874. Section 7874(g) provides broad regulatory authority to adjust the application of the section to prevent avoidance of the purposes of the section through the use of non-corporate entities. Commentators have also agreed that this authority exists. Accordingly, §1.7874–2T(e) provides that a publicly traded foreign partnership will be treated as a foreign corporation for purposes of applying section 7874(a)(2)(B) and §1.7874–2T to determine whether it is a surrogate foreign corporation.

The regulations define *publicly traded foreign partnership* for purposes of this rule as any foreign partnership that would, but for the application of section 7704(c), be treated as a corporation under section 7704 of the Code at any time during the two-year period following the partnership's completion of an acquisition described in section 7874(a)(2)(B)(i). Under section 7704, a partnership is generally treated as a corporation if interests in the partnership are traded on an established securities market, or if interests in the partnership are readily tradable on a secondary market or the substantial equivalent. Section 7704(c) generally provides an exception for a publicly traded partnership where 90 percent or more of its gross income consists of qualifying income (which includes dividends from controlled subsidiaries).

If a publicly traded foreign partnership is within the scope of the regulations, the foreign partnership will be considered to be a foreign corporation, and if it meets the requirements of section 7874(c)(1), may be a member of the EAG, in determining whether it is a surrogate foreign corporation under section 7874(a)(2)(B). For purposes of applying the substantial business activities test of section 7874(a)(2)(B)(iii), the foreign partnership will be considered to be a corporation created or organized in, or under the laws of, the foreign country in which, or under the laws of which, the foreign partnership was created or organized. Moreover, interests in the foreign partnership will be treated as stock of such foreign corporation for purposes of applying the ownership percentage test of section 7874(a)(2)(B)(ii).

If the foreign partnership is considered a surrogate foreign corporation, and the ownership percentage under section 7874(a)(2)(B)(ii) is at least 80 percent, the foreign partnership will be treated under section 7874(b) as a domestic corporation for all purposes of the Code. A conversion rule is provided in the regulations to clarify the Federal income tax consequences of the deemed change from a foreign partnership to a domestic corporation.

In contrast, if the entity is considered a surrogate foreign corporation but the ownership percentage under section 7874(a)(2)(B)(ii) is at least 60 percent but less than 80 percent, the foreign entity will be a foreign partnership for all purposes of the Code, but section 7874(a)(1) will govern the Federal income tax treatment of the expatriated entity (that is, the domestic corporation or domestic partnership whose assets were acquired directly or indirectly by the foreign partnership, and any United States person who is related under sections 267(b) or 707(b)(1)).

Finally, if the publicly traded foreign partnership is not considered to be a surrogate foreign corporation, because the ownership percentage under section 7874(a)(2)(B)(ii) is less than 60 percent, because the EAG has substantial business activities in the country in which, or under the laws of which, the foreign partnership was created or organized, or otherwise, section 7874 will not apply to the foreign partnership, or to the domestic entity, the assets of which it directly or indirectly acquired, and the foreign partnership will continue to be classified as a foreign partnership for all purposes of the Code.

Section 1.7874–2T(e) applies equally to foreign entities that are considered partnerships under both foreign law and U.S. Federal income tax law, and foreign entities that are considered corporate entities under foreign law but are treated as partnerships for U.S. Federal income tax purposes under Treasury regulation §301.7701–3.

The regulations include a provision that explicitly removes from the scope of section 7874 a partnership's deemed acquisition of assets and liabilities under §1.708–1(b)(4) upon a termination of the partnership due to change of ownership. In the absence of such a provision, section 7874 might apply to a deemed acquisition by a publicly traded foreign partnership of a domestic entity representing at least 60 percent of the value of the partnership's assets, merely because of active trading of interests in the partnership. There is no indication in the legislative history that section 7874 was intended to apply in that situation.

Comments were received by the IRS and Treasury Department regarding the consequences under section 7874 where a foreign partnership satisfies the definition of a surrogate foreign corporation when treated as a foreign corporation for definitional purposes. It was argued that, in cases of 80 percent or greater ownership of the foreign partnership by former owners of the acquired domestic entity by reason of their former ownership, the foreign partnership should not be treated as a domestic corporation, despite the language of section 7874(b), but rather should be treated as a domestic partnership. The reasons given included: (1) because a partnership is a flow-through entity for tax purposes, the United States persons owning interests in the partnership would be taxable on the partnership's income, including subpart F income attributable to earnings-stripping transactions between domestic subsidiaries of the partnership and foreign subsidiaries; and (2) the entity classification rules of §§301.7701–2 and 301.7701–3 are intended to allow taxpayers to choose whether a foreign eligible entity is a corporation or partnership for Federal income tax purposes, and section 7874(b) does not impinge on that freedom of choice, but only deems a foreign corporation to be a domestic corporation.

On balance, the IRS and Treasury Department do not find these arguments determinative. Section 7874 does not focus on the taxation of the owners of the acquired domestic entity and the acquiring foreign entity, nor does the statute focus on whether such owners are United States persons or foreign persons. The section imposes tax consequences only on either the acquiring foreign entity or the acquired domestic entity (or related domestic entities). Therefore, the fact that United States persons owning interests in the acquiring partnership would be subject to United States tax on the partnership's income is not determinative of the appropriate treatment of a foreign partnership that is within the scope of section 7874(b) after application of the anti-avoidance rule of paragraph (e) of these regulations.

The argument relating to the entity classification rules has perhaps a stronger foundation. However, for the reasons mentioned above, the IRS and Treasury Department believe that the intention of Congress in enacting both section 7874 and section 7704 is carried out by a rule which treats a publicly traded foreign partnership as a domestic corporation in those circumstances in which the partnership otherwise would be within the scope of section 7874(b) if it were a corporation.

The IRS and Treasury Department recognize that the use of a foreign partnership that is not publicly traded, or the use of a domestic partnership, to acquire the properties of a domestic corporation might enable taxpayers to avoid the purposes of section 7874 in certain cases. Comments are solicited below on whether future regulations under section 7874 or another provision of the Code should address these situations.

2. *Options and similar interests treated as stock of the foreign acquirer*

Based on the regulatory authority provided in section 7874(c)(6), §1.7874–2T(f) of the regulations provides that options and similar interests held by a former shareholder or former partner of the expatriated entity by reason of holding stock or a partnership interest in the expatriated entity will be treated, for purposes of the ownership test of section 7874(a)(2)(B)(ii), as exercised, to the extent that the effect is to treat the foreign corporation as a surrogate foreign corporation. An interest that is similar to an option is defined for these purposes as including, without limitation, a warrant, a convertible debt instrument or other convertible instrument, a put, a stock interest subject to risk of forfeiture, and a contract to acquire or sell stock.

These rules are consistent with existing rules under section 382, which has identical statutory language, in section 382(k)(6)B), to that of section 7874(c)(6). The IRS and Treasury Department are continuing to study whether other types of interests should also be treated as stock of the acquirer under regulations issued under the authority of section 7874(c)(6).

E. *Effects of Section 7874(b)*

Section 1.7874–2T(g) provides that a foreign corporation that is treated as a domestic corporation under section 7874(b) is treated, for purposes of the Code other than determining whether the foreign corporation is a surrogate foreign corporation, as converting to a domestic corporation pursuant to a reorganization described in section 368(a)(1)(F) immediately before the commencement of the acquisition. It follows that, in a case in which the foreign corporation was newly formed for the purpose of the transaction, the effect will be that it is treated as a domestic corporation from its inception. Further, §1.7874–2T(h) provides that, if section 7874(b) applies to a surrogate foreign corporation, section 367 does not apply to any transfer of stock or other property to such entity as part of the acquisition described in section 7874(a)(2)(B)(i).

F. *Effective Dates*

The regulations apply to acquisitions completed on or after the date of their publication in the **Federal Register**. However, taxpayers may apply the regulations to acquisitions completed prior to such date, but must do so consistently with respect to all acquisitions within the scope of the regulations.

Request for Comments

The IRS and Treasury Department are considering issuing subsequent public guidance that addresses additional issues under section 7874. This guidance may address issues related to (1) the determination of whether there has been a direct or indirect acquisition of substantially all the properties held directly or indirectly by a domestic corporation or substantially all the properties constituting a trade or business of a domestic partnership; (2) the requirement that such acquisition be pursuant to a plan or a series of related transactions; (3) the treatment of stock

sold in a public offering that is related to the acquisition; and (4) the disregard of transfers of properties or liabilities if the transfers are part of a plan a principal purpose of which is to avoid the purposes of section 7874. The IRS and Treasury Department specifically request comments regarding appropriate rules in relation to these issues arising under section 7874.

One commentator has recommended that preferred stock described in section 1504(a)(4) should be disregarded in applying the ownership percentage test of section 7874(a)(2)(B)(ii) and the special safe harbor rules of §1.7874–1T(c). The IRS and Treasury Department are carefully considering this recommendation and solicit additional comments as to whether future guidance should include such a rule.

In addition, the IRS and Treasury Department are considering whether and how to amend §1.367(a)–3(c), which deals with the tax consequences of a United States person's transfer of stock of a domestic corporation to a foreign acquiring corporation, as a result of the enactment of section 7874 and the promulgation of regulations thereunder. A commentator has asked for these amendments. Additional comments are requested.

Based on comments received, the IRS and Treasury Department identified inversion transactions using a publicly traded foreign partnership as the new foreign parent entity of the inverted group as a category of transactions requiring a special rule in order to prevent avoidance of the purposes of section 7874, in light of the Congressional purpose in enacting section 7704. Comments are requested as to whether other types of partnerships, such as foreign partnerships that are not publicly traded and domestic partnerships (including limited liability companies), could also be used to avoid the purposes of sections 7874 and 7704, and whether further guidance addressing such avoidance is warranted.

Effective Date

Section 1.7874–2T applies to acquisitions completed on or after June 6, 2006. Taxpayers may elect to apply the section to acquisitions completed prior to that date, but must apply it consistently to all acquisitions within its scope.

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.

These regulations are necessary to provide immediate guidance to prevent avoidance of section 7874 in situations where it should apply as well as to provide immediate guidance on situations where it should not apply. Accordingly, good cause is found for dispensing with notice and public comment pursuant to 5 U.S.C. 553(b)(B) and with a delayed effective date pursuant to 5 U.S.C. 553(d)(3). For 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), this Treasury decision 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 this regulation is Jefferson VanderWolk, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in its development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Sections 1.7874–2T is added to read as follows:

§1.7874–2T Surrogate foreign corporation (temporary).

(a) *Scope*. This section provides rules under section 7874(a)(2)(B) for determining whether a foreign corporation shall be treated as a surrogate foreign corporation. Paragraph (b) of this section provides rules under section 7874(a)(2)(B)(i) regarding the indirect acquisition of properties held directly or indirectly by a domestic corporation or domestic partnership. Paragraph (c) of this section provides rules under section 7874(a)(2)(B)(ii) for identifying stock of the entity held by former shareholders or partners of the domestic entity by reason of holding stock or a partnership interest in the domestic entity. Paragraph (d) of this section provides rules under section 7874(a)(2)(B)(iii) for determining whether the expanded affiliated group (as defined in section 7874(c)(1)) that includes the entity EAG (Expanded Affiliated Group) has substantial business activities in the foreign country in which, or under the laws of which, the entity was created or organized, when compared to the total business activities of the EAG. Paragraph (e) of this section provides rules under which a publicly traded foreign partnership is treated as a foreign corporation for purposes of determining whether it is a surrogate foreign corporation under section 7874(a)(2)(B), and rules regarding the consequences under the Internal Revenue Code if a partnership is treated as a surrogate foreign corporation. Paragraph (f) of this section provides rules under which certain interests held by former shareholders or partners of the domestic entity are treated as stock of the foreign entity making the acquisition described in section 7874(a)(2)(B)(i). Paragraph (g) of this section provides rules relating to the change in status from a foreign corporation to a domestic corporation under section 7874(b). Paragraph (h) of this section provides that section 367 is not applicable to the transfer of assets or stock to a surrogate foreign corporation that is treated as a domestic corporation under section 7874(b).

(b) *Indirect acquisition of properties*—(1) *Acquisition of stock of a domestic corporation*. For purposes of section 7874(a)(2)(B)(i), an acquisition by a foreign corporation of stock of a domestic corporation is considered an indirect acquisition by such foreign corporation of a proportionate amount of the properties held directly or indirectly by such domestic corporation.

(2) *Acquisition of stock of a foreign corporation*. For purposes of section 7874(a)(2)(B)(i), an acquisition by a foreign corporation of stock of a second foreign corporation is not considered an

indirect acquisition by the first foreign corporation of any properties held directly or indirectly by a domestic corporation or domestic partnership owned directly or indirectly, wholly or partly, by the second foreign corporation.

(3) *Acquisition of an interest in a partnership*. For purposes of section 7874(a)(2)(B)(i), an acquisition by a foreign corporation of a capital or profits interest in a foreign or domestic partnership that holds stock in a domestic corporation is considered an indirect acquisition by such foreign corporation of a proportionate amount of the properties held directly or indirectly by such domestic corporation.

(4) *Acquisition of stock or assets of a domestic corporation by controlled subsidiary*. For purposes of section 7874(a)(2)(B)(i) and paragraph (b)(1) of this section, if a corporation acquires stock or assets of a domestic corporation in exchange for stock of a foreign corporation which owns directly or indirectly, after the acquisition, more than 50 percent of the stock (by vote or value) of the acquiring corporation, such foreign corporation is considered as acquiring a proportionate amount of such stock or assets of the domestic corporation.

(5) *Examples*. The application of this paragraph is illustrated by the following examples. It is assumed that all transactions in the examples occur after March 4, 2003. The examples read as follows:

Example 1. Acquisition of stock of domestic corporation. A is a domestic corporation with 100 shares of a single class of common stock outstanding. F, a foreign corporation, acquires 25 shares of A stock from a shareholder of A. For purposes of section 7874(a)(2)(B)(i), F is considered to have made an indirect acquisition of 25% of the properties held directly or indirectly by A.

Example 2. Acquisition of stock of foreign corporation. The facts are the same as in *Example 1* except as follows: All of A's stock is held by B, a foreign corporation. C, a foreign corporation, acquires 25 shares of B stock from a shareholder of B. For purposes of section 7874(a)(2)(B)(i), C is not considered to have made an indirect acquisition of any portion of the properties held directly or indirectly by A.

Example 3. Acquisition of partnership interest. D is a partnership which owns all of the issued and outstanding stock of E, a domestic corporation. G, a foreign corporation, acquires a 40% interest in D from a partner in D. For purposes of section 7874(a)(2)(B)(i), G is considered to have made an indirect acquisition of 40% of the properties held directly or indirectly by E.

Example 4. Acquisition by controlled corporation. FS, a foreign corporation, is 90% owned by foreign corporation FP. Pursuant to a plan of reorganization, FS acquires all the stock of DT, a domestic corporation, in exchange for stock of FP which is exchanged with the shareholders of DT on a one-for-one basis. For purposes of section 7874(a)(2)(B)(i) and paragraph (b)(1) of this section, FP is considered to have acquired 90% of the stock of DT and thus to have made an indirect acquisition of 90% of the properties held directly or indirectly by DT. If FS had acquired substantially all the assets of DT, rather than the stock of DT, in exchange for stock of FP, FP would be considered to have acquired 90% of the assets of DT for purposes of section 7874(a)(2)(B)(i).

(c) *Stock held by former shareholders or partners by reason of holding stock or a partnership interest in the domestic entity*—(1) *General rule*. For purposes of section 7874(a)(2)(B)(ii), stock of the foreign corporation which is received by a former shareholder of the domestic corporation in exchange for stock of the domestic corporation is considered stock held by reason of holding stock in the domestic corporation. Similarly, for purposes of section 7874(a)(2)(B)(ii), stock of the foreign corporation which is received by a former partner of the domestic partnership in exchange for a capital or profits interest in the domestic partnership is considered stock held by reason of holding a capital or profits interest in the domestic partnership. Subject to section 7874(c)(4), in cases where the foreign corporation also issues stock to a former shareholder of the domestic corporation or partner of the domestic partnership in the same transaction or series of transactions in exchange for consideration other than stock in the domestic corporation or a capital or profits interest in the domestic partnership, the percentage of the foreign corporation's stock considered to be held by former shareholders of the domestic corporation or former partners of the domestic partnership by reason of holding stock in the domestic corporation or a capital or profits interest in the domestic partnership shall be determined on the basis of the relative value of the property in exchange for which the foreign corporation's stock was issued.

(2) *Former shareholders and former partners*. For purposes of this section, former shareholders of the domestic corporation are persons who held stock in the domestic corporation before the acquisition, including persons (if any) who held stock in the domestic corporation both before and after the acquisition. Former partners of the domestic partnership are persons who held a capital or profits interest in the domestic partnership before the acquisition, including persons (if any) who held a capital or profits interest in the domestic partnership both before and after the acquisition.

(3) *Example*. The following example illustrates the application of this paragraph:

Example. Contribution of stock of domestic and foreign corporations. A holds all of the issued and outstanding common stock of DC, FC1, FC2, and FC3. DC is a domestic corporation, and FC1, FC2, and FC3 are foreign corporations. Each of DC, FC1, FC2, and FC3 has only one class of stock outstanding. DC's outstanding stock is worth $40x, FC1's outstanding stock is worth $20x, FC2's outstanding stock is worth $25x, and FC3's outstanding stock is worth $15x. In a transaction subject to section 351, A contributes the stock of DC, FC1, FC2, and FC3 to FP, a foreign corporation, in exchange for all of the issued and outstanding common stock of FP. The transaction occurs after March 4, 2003. For purposes of section 7874(a)(2)(B)(ii), A is considered to hold 40% of the stock of FP by reason of holding stock in DC.

(d) *Substantial business activities of the EAG*—(1) *General rule*—(i) *Facts and circumstances test*. Subject to paragraph (d)(2) of this section, the determination of whether, after the acquisition, the EAG has substantial business activities in the foreign country in which, or under the law of which, the acquiring foreign entity is created or organized, when compared to the total business activities of the EAG, shall be made on the basis of all of the facts and circumstances. However, the factors described in paragraph (d)(1)(iii) of this section shall not be taken into account in making the determination. For the EAG to have substantial business activities in the foreign country when compared to the total business activities of the EAG, there is no minimum percentage of its total business activities (regardless of how measured) that must be in the foreign country. It is necessary, however, for the determination of substantiality to be made on the basis of a comparison to the total business activities of the EAG, and the factors set forth in paragraph (d)(1)(ii) of this section are to be evaluated accordingly. Thus, it is possible that the business activities of an EAG in a particular country would be substantial when compared to the total business activities of such EAG, but the identical business activities of another EAG in the same country would not be substantial when compared to the total business activities of that EAG because

the total business activities of the second EAG were much more extensive than the total business activities of the first EAG.

(ii) *Factors to be considered*. Relevant factors indicating that the EAG has substantial business activities in the foreign country when compared to the total business activities of the EAG include, but are not limited to, the factors set forth below. The presence or absence of any factor, or of a particular number of factors, is not determinative. Moreover, the weight given to any factor (whether or not set forth below) depends on the particular case. Relevant factors include, but are not limited to —

(A) *Historical presence*. The conduct of continuous business activities in the foreign country by EAG members prior to the acquisition;

(B) *Operational activities*. Business activities of the EAG in the foreign country occurring in the ordinary course of the active conduct of one or more trades or businesses, involving—

(*1*) Property located in the foreign country which is owned by members of the EAG;

(*2*) The performance of services by individuals in the foreign country who are employed by members of the EAG; and

(*3*) Sales to customers in the foreign country by EAG members;

(C) *Management activities*. The performance in the foreign country of substantial managerial activities by EAG members' officers and employees who are based in the foreign country;

(D) *Ownership*. A substantial degree of ownership of the EAG by investors resident in the foreign country.

(E) *Strategic factors*. The existence of business activities in the foreign country that are material to the achievement of the EAG's overall business objectives.

(iii) *Factors not to be considered*. Any assets, activities, or income attributable to a transfer or transfers disregarded under section 7874(c)(4) are not relevant factors to be considered. In addition, any assets that are temporarily located in a foreign country at any time as part of a plan a principal purpose of which is to avoid the purposes of section 7874 are not relevant factors to be considered.

(2) *Safe harbor*—(i) *Elements*. The EAG will be considered to have substantial business activities, after the acquisition, in the foreign country in which, or under the law of which, the acquiring foreign entity was created or organized, when compared to the total business activities of the EAG, if paragraphs (d)(2)(ii), (iii), and (iv) of this section apply.

(ii) *Employees*. This paragraph (d)(2)(ii) applies if, after the acquisition, the group employees based in the foreign country account for at least 10 percent (by headcount and compensation) of total group employees.

(iii) *Assets*. This paragraph (d)(2)(iii) applies if, after the acquisition, the total value of the group assets located in the foreign country is at least 10 percent of the total value of all group assets.

(iv) *Sales*. This paragraph (d)(2)(iv) applies if, during the testing period, the group sales made in the foreign country accounted for at least 10 percent of total group sales.

(3) *Definitions and application of rules*. For purposes of paragraph (d) of this section—

(i) The term *group employee* means a common law employee of one or more members of the EAG who worked full time (meaning normally 35 or more hours per week) throughout the testing period. An independent contractor performing activities on behalf of an EAG member is not a group employee. A group employee is considered to be based in a country only if the group employee spent more time providing services in such country than in any other country throughout the testing period and continues to provide services in such country immediately after the acquisition. The compensation of a group employee is determined in United States dollars and, in the case of compensation denominated in a foreign currency, translated into United States dollars using the weighted average exchange rate for the taxable year, as defined in §1.989(b)–1.

(ii) The term *group assets* means tangible property used or held for use in the active conduct of a trade or business by a member of the EAG. An item of tangible personal property is considered to be located in a country only if such item was physically present in such country for more time than in any other country during the testing period. The total value of group assets is determined for purposes of this paragraph on the last day of the testing period, on a gross basis (that is, not reduced by liabilities), measured by either tax book value or fair market value, but not both, in United States dollars translated if necessary at the spot rate determined under the principles of §1.988–1(d)(1), (2) and (4). Group assets do not include property located in a country by reason of a transfer, or a change of geographic location, pursuant to a plan a principal purpose of which is to avoid the application of section 7874. In addition, intangible assets are not taken into account (in either the numerator or denominator) in calculating the amount of group assets.

(iii) The term *group sales* means sales and the provision of services by members of the EAG, measured by gross receipts from such sales and services, in United States dollars (determined, in the case of gross receipts denominated in a foreign currency, using the weighted average exchange rate for the taxable year, as defined in Treas. Reg. §1.989(b)–1). A group sale is considered to be made in a country only if the services, goods or other property transferred by such sale are sold for use, consumption or disposition in such country.

(iv) If one or more members of the EAG own capital or profits interests in a partnership, the proportionate amount of activities, employees, assets, income and sales of such partnership are considered to be activities, employees, assets, income and sales of the member or members of the EAG. A partner's proportionate share shall be determined under the rules and principles of sections 701 through 706 and the regulations thereunder.

(v) The term *testing period* means the 12 month period ending on the last day of the EAG's monthly or quarterly management accounting period in which the acquisition is completed and the term *after the acquisition* means, for purposes of paragraphs (d)(1)(i) and (d)(2)(ii) and (iii) of this section, the last day of the testing period.

(4) *Examples*. The application of paragraph (d)(1) of this section is illustrated by the following examples of business activities of an EAG in a foreign country after an acquisition described in section 7874(a)(2)(B)(i). In each example, the acquiring foreign entity is incorporated in Country A. Paragraph (d)(2) of this section does not apply to any of the examples. The examples are not intended to allow any

inferences to be drawn as to whether the presence or absence, in a particular case, of one or more facts described in an example is determinative as to whether an EAG does, or does not, have substantial business activities in the relevant foreign country when compared to the total business activities of the EAG. The examples read as follows:

Example 1. Administrative activities and some customer services—(i) *Facts*. Group employees based in Country A regularly perform administrative, back office services for other EAG members, and regularly provide customer service globally via telephone and email at a communications center located in Country A. After the acquisition, fewer than 2% of group employees are based in Country A. Less than 3% of group sales were made in Country A in the 12-month period ending on the date of the acquisition. The total value of group assets located in Country A on the date of the acquisition is approximately 2% of total group assets. None of the EAG's senior managers are based in Country A.

(ii) *Conclusion*. In light of all the facts and circumstances, after the acquisition, the EAG does not have substantial business activities in Country A when compared to the total business activities of the EAG.

Example 2. Manufacturing in foreign country—(i) *Facts*. EAG members own and have continuously operated a manufacturing facility and warehouses in Country A for several years prior to the acquisition. The goods produced in Country A represented approximately 2% of the total value of the EAG's production of finished goods in the 12-month period ending on the date of the acquisition. Group employees based in Country A also regularly perform back office services for other EAG members. Fewer than 5% of group employees were based in Country A during the 12-month period ending after the acquisition. Less than 2% of group sales were made in Country A during the 12-month period ending after the acquisition. The total value of group assets located in Country A after the acquisition is approximately 4% of total group assets. None of the EAG's senior managers are based in Country A.

(ii) *Conclusion*. In light of all the facts and circumstances, after the acquisition, the EAG does not have substantial business activities in Country A when compared to the total business activities of the EAG.

Example 3. Financial services group; real estate in foreign country—(i) *Facts*. The EAG's main line of business is financial services. Group employees based in Country A regularly perform back office services for other EAG members. Fewer than 5% of group employees were based in Country A during the 12-month period ending on the date of the acquisition. Less than 3% of group sales were made in Country A during the same period. However, the total value of group assets located in Country A after the acquisition is more than 10% of the value of total group assets, due to the fact that EAG members purchased a substantial amount of commercial and residential real estate in Country A during the 24 months preceding the acquisition. The management of the real estate is performed by an unrelated independent agent. Most of the EAG's senior managers are based outside Country A. The EAG's real estate portfolio in Country A was not acquired pursuant to a strategic plan for one or more of the EAG's worldwide lines of business, nor are the EAG's business activities in Country A material to the achievement of the EAG's overall business objectives.

(ii) *Conclusion*. In light of all the facts and circumstances, after the acquisition, the EAG does not have substantial business activities in Country A when compared to the total business activities of the EAG.

Example 4. Foreign group merging with larger U.S. group—(i) *Facts*. The Country A corporation that is the parent entity in the EAG acquired a domestic corporation and its subsidiaries pursuant to a merger agreement. Before the merger, the stock of both the Country A corporation and the domestic corporation was publicly traded in their respective countries of incorporation. The two groups were competitors in the same global line of business for many years preceding the merger. The merger was prompted by a third group's attempt to obtain control of the domestic corporation and its subsidiaries without the consent of the management of the domestic corporation. After the merger, the Country A corporation is more than 60% owned by former shareholders of the domestic corporation, due to the fact that the domestic corporation was significantly more valuable than the Country A corporation. After the merger, the stock of the Country A corporation is publicly traded on stock exchanges in both Country A and the United States. Group employees based in Country A perform all of the functions involved in the EAG's overall business activities, including headquarters and senior management functions. After the merger, approximately 11% of group employees are based in Country A, the total value of group assets located in Country A is approximately 10% of the value of total group assets, and the estimated percentage of group sales that will be made in Country A during the year following the merger is approximately 7%.

(ii) *Conclusion*. In light of all the facts and circumstances, after the acquisition, the EAG has substantial business activities in Country A when compared to the total business activities of the EAG.

Example 5. Relocation of business to foreign country—(i) *Facts*. The EAG's business involves advanced technology. The controlling shareholders of the Country A corporation that is the parent entity in the EAG, and the senior managers of the EAG, are resident in Country A. The controlling shareholders originally established DC, a domestic corporation, which established its head office in City B in the United States, where a leading institute of technology is located. Part of DC's business strategy was to hire research personnel who had been trained at the institute of technology and had settled in City B. DC hired 10 researchers who worked at DC's premises in City B. DC also established FS, a wholly owned Country A subsidiary, which hired research personnel in Country A to perform research and product development functions at FS's premises in Country A. Subsequently, the senior managers and controlling shareholders adopted a new business strategy involving the closure of the U.S. operations and the transfer of DC's business and FS's stock to FP, a new Country A corporation, with the result of centering the EAG's business in Country A. Pursuant to the new strategy, DC terminated the employment of seven researchers and the lease on its City B premises, relocated the other three researchers from City B to Country A, and transferred its remaining assets, including the stock of FS, to FP in exchange for more than 80% of the stock of FP. After the acquisition, substantially all of the group employees were based in Country A, and substantially all of the group assets were located in Country A.

(ii) *Conclusion*. In light of all the facts and circumstances, after the acquisition, the EAG has substantial business activities in Country A when compared to the total business activities of the EAG.

(e) *Acquisition by publicly traded foreign partnership*—(1) *Treatment as a foreign corporation*. For purposes of applying section 7874(a)(2)(B) and this section, a publicly traded foreign partnership shall be treated as a foreign corporation created or organized in, or under the laws of, the foreign country in which, or under the laws of which, such partnership was created or organized, and interests in such partnership shall be treated as stock of such foreign corporation. In determining whether the publicly traded foreign partnership is a surrogate foreign corporation, the publicly traded foreign partnership will be treated as a member of the EAG, if the requirements of section 7874(c)(1) are met. If this paragraph is applicable and the provisions of section 7874(a)(2)(B) are satisfied such that the foreign entity making the acquisition is a surrogate foreign corporation to which section 7874(b) applies, the foreign entity shall be treated as a domestic corporation for purposes of the Internal Revenue Code. See paragraph (e)(3) of this section for the deemed treatment of the change in form from a foreign partnership to a domestic corporation. If this paragraph is applicable and the provisions of section 7874(a)(2)(B) are satisfied such that the foreign entity making the acquisition is a surrogate foreign corporation to which section 7874(b) does not apply, the foreign entity shall continue to be a foreign partnership for purposes of the Internal Revenue Code, but the tax treatment of the expatriated entity shall be governed by section 7874(a)(1). If this paragraph is applicable, but the provisions of section 7874(a)(2)(B) are not satisfied such that the foreign partnership making the acquisition is not a surrogate foreign corporation, the status of the publicly traded foreign partnership will not be affected by section 7874 or §1.7874–2T.

(2) *Publicly traded foreign partnership*. For purposes of this section, the term *publicly traded foreign partnership* means any

foreign partnership that would, but for the application of section 7704(c), be treated as a corporation under section 7704 at any time during the two-year period following the partnership's completion of an acquisition described in section 7874(a)(2)(B)(i).

(3) *Deemed treatment of change from foreign partnership to domestic corporation*. Except for purposes of determining whether it is a surrogate foreign corporation under section 7874(a)(2)(B) and §1.7874–2T, a foreign partnership that is treated as a domestic corporation pursuant to the application of paragraph (e)(1) of this section and the application of section 7874(b) and §1.7874–2T shall, immediately before commencement of the acquisition, be treated as transferring all of its assets and liabilities to a newly formed domestic corporation in exchange for the stock of the domestic corporation, and distributing such stock to its partners in liquidation of their interests in the partnership. The tax treatment of the transaction shall be determined under all relevant provisions of the Internal Revenue Code and general principles of tax law, including the step transaction doctrine.

(4) *Disregard of deemed acquisition*. For purposes of paragraph (e)(1) of this section, a publicly traded foreign partnership's deemed acquisition of assets and liabilities under §1.708–1(b)(4) is not a direct or indirect acquisition of properties to which section 7874(a)(2)(B)(i) could apply.

(5) *Examples*. The application of this paragraph is illustrated by the following examples. It is assumed that all transactions in the examples occur after March 4, 2003, and that any foreign partnership referred to in an example is not treated as a corporation under section 7704. The examples read as follows:

Example 1. Foreign hybrid entity; public trading of ownership interests on stock market following triangular merger—(i) *Facts*. The stock of DP, a domestic corporation, is publicly traded on stock exchange SE. Pursuant to a plan, DP and an unrelated person form a foreign subsidiary entity, FQ, under the laws of foreign country X, transferring a minimal amount of cash to FQ in the process. DP owns 99.9% of FQ and the unrelated party owns 0.1% of FQ. FQ is a limited liability company and is a foreign eligible entity under §301.7701–2. FQ makes an election under §301.7701–3 to be treated as a partnership for Federal income tax purposes as of the date of its formation. FQ forms a wholly owned domestic corporation, DS, under the laws of State A. Under a merger agreement and State A law, DS merges into DP, with DP surviving the merger as a wholly owned subsidiary of FQ and the former shareholders of DP receiving ownership interests in FQ in exchange for their DP stock. On the day of the merger, the stock of DP ceases to be listed on stock exchange SE. Trading of ownership interests of FQ on stock exchange SE commences on the day after the day of the merger. FQ, however, is not treated as a corporation under section 7704, due to the application of section 7704(c). After the acquisition, the corporate group owned by FQ does not have substantial business activities in foreign country X when compared to its total business activities.

(ii) *Analysis*. FQ is a publicly traded foreign partnership under paragraph (e)(1) of this section. For purposes of determining whether FQ is a surrogate foreign corporation under section 7874(a)(2)(B), FQ is considered to be a foreign corporation rather than a foreign partnership, and ownership interests in FQ are considered to be stock of FQ. Therefore, on the basis of these facts, FQ is a surrogate foreign corporation because all of the conditions stated in section 7874(a)(2)(B) are satisfied. Because the former shareholders of DP hold more than 80% of FQ's ownership interests, FQ is treated under section 7874(b) as a domestic corporation for purposes of the Internal Revenue Code. In addition, the former shareholders of DP are treated as having received stock of domestic corporation FQ in exchange for their stock of DP.

Example 2. Substantial business activities of the EAG in the foreign country of incorporation—(i) *Facts*. The facts are the same as in *Example 1* except that, after the acquisition, the EAG that includes FQ has substantial business activities in foreign country X when compared to the total business activities of the EAG under the criteria set forth in paragraph (d) of this section.

(ii) *Analysis*. For purposes of determining whether FQ is a surrogate foreign corporation under section 7874(a)(2)(B), FQ is considered to be a foreign corporation rather than a foreign partnership, and ownership interests in FQ are considered to be stock of FQ. On the basis of these facts, FQ is not a surrogate foreign corporation, because, after the acquisition, the EAG that includes FQ has substantial business activities in foreign country X when compared to the total business activities of the EAG. Therefore, section 7874 does not apply to the acquisition, and the status of FQ as a foreign partnership is unaffected.

Example 3. Acquisition by publicly traded foreign partnership owned by former shareholders and unrelated persons—(i) *Facts*. The facts are the same as in *Example 1* except that, at the time of the merger transaction, unrelated persons who did not own any stock of DP transfer stock of a foreign corporation to FQ in exchange for 25% of the ownership interests in FQ. Former shareholders of DP receive 75% of the ownership interests in FQ.

(ii) *Analysis*. For purposes of determining whether FQ is a surrogate foreign corporation under section 7874(a)(2)(B), FQ is considered to be a foreign corporation rather than a foreign partnership, and ownership interests in FQ are considered to be stock of FQ. Therefore, on the basis of these facts, and taking into account the provisions of section 7874(c)(4), FQ is a surrogate foreign corporation, because all of the conditions stated in section 7874(a)(2)(B) are satisfied. Because the former shareholders of DP hold less than 80% of FQ's ownership interests, FQ is not treated under section 7874(b) as a domestic corporation for purposes of the Internal Revenue Code. Rather, FQ is a foreign partnership for purposes of the Internal Revenue Code, and section 7874(a)(1) applies in determining the Federal income tax liability of DP and any other expatriated entity (as defined in section 7874(a)(2)).

(f) *Options and similar interests treated as stock of the foreign acquiring corporation*—(1) *General rule*. For purposes of section 7874(a)(2)(B)(ii), options and interests that are similar to options held by a person by reason of holding stock in the domestic corporation or a capital or profits interest in the domestic partnership described in section 7874(a)(2)(B)(i) shall be treated as exercised. The prior sentence shall apply, however, only to the extent that the effect of such exercise is to treat the foreign entity that has made the acquisition described in section 7874(a)(2)(B)(i) as a surrogate foreign corporation under section 7874(a)(2)(B).

(2) *Interests that are similar to options*. For purposes of paragraph (f)(1) of this section, an interest that is similar to an option includes, but is not limited to, a warrant, a convertible debt instrument, an instrument other than debt that is convertible into stock, a put, a stock interest subject to risk of forfeiture, and a contract to acquire or sell stock.

(3) *Example*. The application of this paragraph is illustrated by the following example. It is assumed that the transaction in the example occurs after March 4, 2003. The example reads as follows:

Example. Convertible bonds treated as stock of foreign corporation—(i) *Facts*. DT, a domestic corporation with 80 shares of stock issued and outstanding, is owned by a group of individuals. FA, a foreign corporation unrelated to DT, has 20 shares of stock issued and outstanding. Pursuant to a plan, the shareholders of DT transfer all of their shares of DT to FA in exchange for 25 newly issued shares of FA stock (with a value of $25x) and $55x of FA bonds that are convertible at the election of the holder into 55 shares of FA stock, for no additional consideration, at any time during the ensuing 5-year period. After the acquisition, the EAG that includes FA does not have substantial business activities in FA's country of incorporation when compared to the total business activities of the EAG.

(ii) *Analysis*. FA has indirectly acquired substantially all the properties held directly or indirectly by DT pursuant to a plan. Before the application of this paragraph (f), the former shareholders of DT own 25 shares of FA stock by reason of holding stock in DT. Accordingly, the section 7874(a)(2)(B)(ii) fraction would be 25/45, the resulting percentage would be 55%, and FA would not be a surrogate foreign corporation. Pursuant to paragraph (f)(2) of this sec-

tion, the FA convertible bonds issued to the former shareholders of DT are treated as interests that are similar to options. As a result, and pursuant to paragraph (f)(1) of this section, the convertible bonds are treated as being converted into 55 shares of FA stock for purposes of section 7874(a)(2)(B)(ii). Therefore, the section 7874(a)(2)(B)(ii) fraction is 80/100, the resulting percentage is 80% and FA is a surrogate foreign corporation. In addition, pursuant to section 7874(b), FA is treated as a domestic corporation.

(g) *Change from foreign to domestic status*—(1) *Conversion*—(i) *General rule*. Except for purposes of determining whether it is a surrogate foreign corporation under section 7874(a)(2)(B) and §1.7874–2T, the conversion of a foreign corporation to a domestic corporation under section 7874(b) shall, immediately before commencement of the acquisition described in section 7874(a)(2)(B)(i), be treated as a reorganization described in section 368(a)(1)(F). For the consequences of the conversion, see §1.367(b)–2(f). See also §1.367(b)–3. The tax treatment of all aspects of the transaction other than such conversion shall be determined under all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine.

(ii) *Example*. The following example illustrates the application of paragraph (g)(1)(i) of this section. It is assumed that the transaction in the example occurs after March 4, 2003. The example reads as follows:

Example. Conversion treated as reorganization under section 368(a)(1)(F)—(i) *Facts*. DT, a domestic corporation is owned by a group of individuals. FA, a foreign corporation unrelated to DT which has been conducting a trade or business for several years, has 20 shares of stock issued and outstanding. Pursuant to a plan, the shareholders of DT transfer all of their shares of DT to FA in exchange for 80 newly issued shares of FA stock. After the acquisition, the EAG that includes FA does not have substantial business activities in FA's country of incorporation when compared to the total business activities of the EAG.

(ii) *Analysis*. FA has indirectly acquired substantially all the properties held directly or indirectly by DT pursuant to a plan. After the acquisition, the former shareholders of DT own 80 shares of FA stock by reason of holding stock in DT. Accordingly, the section 7874(a)(2)(B)(ii) fraction is 80/100, the resulting percentage is 80%, and FA is a surrogate foreign corporation. In addition, pursuant to section 7874(b), FA is treated as a domestic corporation. Other than for purposes of determining whether FA is a surrogate foreign corporation, the conversion of FA from a foreign corporation to a domestic corporation shall, immediately before FA's acquisition of the DT stock, be treated as a reorganization under section 368(a)(1)(F). See §§1.367(b)–2(f) and 1.367(b)–3. The tax treatment of all other aspects of the transaction, including the acquisition of the DT stock by FA, is determined under all relevant provisions of the Code and general principles of tax law, including the step transaction doctrine.

(2) *Entity classification*. An entity that is treated as a domestic corporation under section 7874(b) is not an eligible entity as defined in §301.7701–3(a) of this chapter and therefore may not elect noncorporate status.

(3) *Time of determination*. Subject to the application of the step transaction doctrine and section 7874(c)(4), the determination of whether a foreign entity is a surrogate foreign corporation is made immediately after completion of the acquisition described in section 7874(a)(2)(B)(i), except as provided in paragraphs (d)(3)(v) and (e)(2) of this section. A foreign entity that is treated as a domestic corporation under section 7874(b) shall continue to be treated as a domestic corporation without regard to whether the provisions of section 7874(a)(2)(B)(ii) and (iii) are satisfied at a later time.

(h) *Nonapplication of section 367*—(1) *General rule*. If section 7874(b) applies to a surrogate foreign corporation, section 367 shall not apply to the transfer of stock or other property to such entity as part of the acquisition described in section 7874(a)(2)(B)(i).

(2) *Example*. The following example illustrates the application of paragraphs (g) and (h)(1) of this section. It is assumed that the transaction in the example occurs after March 4, 2003. The example reads as follows:

Example. Conversion of foreign corporation to domestic corporation—(i) *Facts*. FP, a newly formed foreign corporation, acquires pursuant to a plan substantially all of the stock of DX, a domestic corporation, by issuing its stock to the owners of DX in exchange for their DX stock. The former owners of DX, all of whom are U.S. persons, hold more than 80% of the stock of FP by reason of their ownership of DX stock. The EAG that includes FP does not have substantial business activities in FP's country of incorporation after the acquisition when compared to the total business activities of the EAG.

(ii) *Analysis*. FP is a surrogate foreign corporation under section 7874(a)(2)(B). Under section 7874(b), FP is treated as a domestic corporation for purposes of the Internal Revenue Code. In addition, the former owners of DX are not subject to section 367 with respect to the transfer of their DX stock to FP.

(i) [*Reserved.*]

(j) *Effective date*. This section shall apply to acquisitions completed on or after June 6, 2006. However, taxpayers may apply this section to acquisitions completed prior to that date, but must apply it consistently to all acquisitions within its scope.

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

Approved May 22, 2006.

Eric Solomon,
Acting Deputy Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 5, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 6, 2006, 71 F.R. 32437)

Part III. Administrative, Procedural, and Miscellaneous

Postponement of Filing Date for Form 8898

Notice 2006–57

PURPOSE

This notice postpones until October 16, 2006, the due date for filing Form 8898, *Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession*, for tax years 2001 through 2005.

BACKGROUND

Section 937 was added to the Internal Revenue Code by section 908 of the American Jobs Creation Act of 2004, Public Law 108–357. Section 937(c) generally requires individuals who take the position for U.S. income tax reporting purposes that they became, or ceased to be, a *bona fide* resident of American Samoa, Guam, the Northern Mariana Islands, Puerto Rico, or the United States Virgin Islands to file notice of such position. Such a change in residence must be reported for taxable years ending after October 22, 2004, as well as for any of an individual's preceding three taxable years. Thus, for calendar year taxpayers as of the date of this notice, if any individual changed residence to or from a U.S. possession during any of the tax years 2001, 2002, 2003, 2004, or 2005, information reporting generally is required for each of those tax years in which there is a change of residence.

Under section 937(c) and Treas. Reg. § 1.937–1(h)(1), the IRS may prescribe the time and manner by which taxpayers are to provide such notice of their change in residence. On April 18, 2006, the IRS released Form 8898, *Statement for Individuals Who Begin or End Bona Fide Residence in a U.S. Possession*, on which the information reporting required under section 937(c) is to be made. See IRS Announcement 2006–25, 2006–18 I.R.B. 871.

The instructions to Form 8898 provide that, beginning with tax year 2001, an individual with worldwide gross income of more than $75,000 must file Form 8898 for the tax year in which the individual becomes or ceases to be a *bona fide* resident of a U.S. possession. The due date prescribed in the instructions for filing Form 8898 is the due date (including extensions) for filing Form 1040 or Form 1040NR, except that for tax years 2001 through 2005, Form 8898 must be filed by July 17, 2006 (or, for 2005, any extended due date).

Since release of Form 8898, taxpayers have expressed the view that in a significant number of cases, the prescribed due date will not allow adequate time to gather and comply with the information reporting requirements of Form 8898 for prior years.

GRANT OF RELIEF

The IRS has granted a postponement of time for taxpayers to file Form 8898 for tax years 2001 through 2005 until the automatic extended due date (irrespective of whether the taxpayer applied for an extension) for filing Form 1040 or Form 1040NR for the 2005 calendar year. Accordingly, taxpayers who changed their residence to or from a U.S. possession during any of those tax years must file Form 8898 by October 16, 2006. Except for this postponement of the due date, Form 8898 must be filed in accordance with the form instructions.

DRAFTING INFORMATION

The principal author of this notice is J. David Varley of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Varley at (202) 435–5262 (not a toll-free call).

NOTE: Use this revenue procedure to prepare Forms 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, for submission to Internal Revenue Service (IRS) using either of the following:

- Tape Cartridges
- Electronic Filing

Please read this publication carefully. Persons required to file may be subject to penalties if they do not follow the instructions in this revenue procedure.

Note: IRS/ECC-MTB no longer accepts 3½-inch diskettes for the filing of information returns including Form 8027.

For tax year 2008 forms filed in calendar year 2009, IRS/ECC-MTB will no longer accept tape cartridges. Electronic filing will be the ONLY acceptable method for filing Form 8027 with ECC-MTB.

26 CFR 601.602: Tax forms and instructions.

Rev. Proc. 2006–29

TABLE OF CONTENTS

PART A. GENERAL

SEC. 1. PURPOSE 15

SEC. 2. NATURE OF CHANGES 15

SEC. 3. WHERE TO FILE AND HOW TO CONTACT THE IRS, ENTERPRISE COMPUTING CENTER — MARTINSBURG 15

SEC. 4. FILING REQUIREMENTS 16

SEC. 5. FORM 8508, REQUEST FOR WAIVER FROM FILING INFORMATION RETURNS ELECTRONICALLY/MAGNETICALLY 16

SEC. 6. FORM 4419, APPLICATION FOR FILING INFORMATION RETURNS ELECTRONICALLY/MAGNETICALLY 16

SEC. 7. TEST FILES 17

SEC. 8. FILING FORMS 8027 ELECTRONICALLY/MAGNETICALLY 17

SEC. 9. DUE DATES 18

SEC. 10. STATE ABBREVIATIONS 18

SEC. 11. EXTENSION OF TIME 18

SEC. 12. PROCESSING OF INFORMATION RETURNS ELECTRONICALLY/MAGNETICALLY 19

SEC. 13. PENALTIES 20

SEC. 14. CORRECTED RETURNS, SUBSTITUTE FORMS, AND COMPUTER-GENERATED FORMS 20

SEC. 15. EFFECT ON PAPER RETURNS 20

SEC. 16. DEFINITION OF TERMS 21

PART B. ELECTRONIC FILING SPECIFICATIONS

SEC. 1. GENERAL 21

SEC. 2. ADVANTAGES OF FILING ELECTRONICALLY 22

SEC. 3. ELECTRONIC FILING APPROVAL PROCEDURE 22

SEC. 4. TEST FILES 22

SEC. 5. ELECTRONIC SUBMISSIONS 22

SEC. 6. PIN REQUIREMENTS 23

SEC. 7. ELECTRONIC FILING SPECIFICATIONS 23

SEC. 8. CONNECTING TO THE FIRE SYSTEM 23

SEC. 9. COMMON PROBLEMS AND QUESTIONS ASSOCIATED WITH ELECTRONIC FILING 25

PART C. FILING SPECIFICATIONS AND RECORD LAYOUT

SEC. 1. TAPE CARTRIDGE SPECIFICATIONS 26

SEC. 2. RECORD FORMAT AND LAYOUT 27

PART A. GENERAL

Sec. 1. Purpose

.01 Form 8027 is used by large food or beverage establishments when the employer is required to make annual reports to the IRS on receipts from food or beverage operations and tips reported by employees.

Note: All employees receiving $20.00 or more a month in tips must report 100% of their tips to their employer.

.02 The Internal Revenue Service Enterprise Computing Center — Martinsburg (IRS/ECC-MTB) has the responsibility of processing Forms 8027 submitted electronically/magnetically. The purpose of this revenue procedure is to provide the specifications for filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Electronically or Magnetically. This revenue procedure is updated when legislative changes occur or reporting procedures are modified. Major changes have been emphasized by italics.

.03 This revenue procedure supersedes the following: Rev. Proc. 2005–41 published as Publication 1239 (Rev. 6–2005), Specifications for Filing Form 8027, Employer's Annual Information Return of Tip Income and Allocated Tips, Magnetically or Electronically. This revenue procedure is effective for Forms 8027 due the last day of February 2007 and any returns filed thereafter.

Sec. 2. Nature of Changes

Numerous editorial changes have been made to the revenue procedure. Please read the publication carefully and in its entirety before attempting to prepare your electronic/magnetic file for submission. Major changes have been emphasized by using italics. The changes are as follows:

.01 The Martinsburg Computing Center's name was changed to the Enterprise Computing Center – Martinsburg (ECC-MTB).

.02 IRS/ECC-MTB no longer accepts 3½-inch diskettes for the filing of information returns including Form 8027.

.03 The record length was increased to 420 positions to accommodate four new fields.

.04 The new field Final Return Indicator, position 371, was added.

.05 The new field Charge Card Indicator, position 372, was added.

.06 The new field ATIP Indicator, position 373, was added.

.07 The new field Liable/Not Liable Indicator, position 374 was added.

.08 Positions 375–418 are held in reserve for future information.

.09 Positions 419–420 are blank.

Sec. 3. Where to File and How to Contact the IRS, Enterprise Computing Center — Martinsburg

.01 All Forms 8027 filed magnetically are processed at IRS/ECC-MTB and are to be sent to the following address:

IRS-Enterprise Computing Center - Martinsburg
Information Reporting Program
240 Murall Drive
Kearneysville, WV 25430

.02 Requests for paper forms and publications should be requested by calling the "Forms Only Number" listed in your local telephone directory or by calling the IRS toll-free number **1–800–TAX–FORM (1–800–829–3676).**

.03 Questions pertaining to magnetic media filing of Forms W–2 **must** be directed to the Social Security Administration (SSA). Filers can call 1–800–SSA–6270 to obtain the phone number of the SSA Employer Services Liaison Officers for their area.

.04 A taxpayer or authorized representative may request a copy of a tax return or a Form W–2 filed with a return by submitting Form 4506, Request for Copy of Tax Form, to IRS. This form may be obtained by calling **1–800–TAX–FORM (1–800–829–3676).**

.05 The Information Reporting Program Customer Service Section (IRP/CSS), located at IRS/ECC-MTB, answers electronic, tape cartridge, paper filing, and tax law questions from the payer community relating to the correct preparation and filing of business information returns (Forms 1096, 1098, 1099, 5498, 8027, and W–2G). IRP/CSS also answers questions relating to the electronic or tape cartridge filing of Forms 1042–S and to the tax law criteria and paper filing instructions for Forms W–2 and W–3. Inquiries dealing with backup withholding and reasonable cause requirements due to missing and incorrect taxpayer identification numbers are also addressed by IRP/CSS. Assistance is available year-round to payers, transmitters, and employers nationwide, Monday through Friday, 8:30 a.m. to 4:30 p.m. Eastern Time, by calling toll-free **1–866–455–7438** or via email at mccirp@irs.gov. ***Do not include SSNs or EINs in emails or attachments since this is not a secure line.*** The Telecommunications Device for the Deaf (TDD) toll number is **304–267–3367.** Call as soon as questions arise to avoid the busy filing seasons at the end of January and February. Recipients of information returns (payees) should continue to contact 1–800–829–1040 with any questions on how to report the information returns data on their tax returns.

.06 The telephone numbers for tape cartridge or electronic submissions are:

Information Reporting Program Customer Service Section

TOLL-FREE 1–866–455–7438 or outside the U.S. 1–304–263–8700

email at mccirp@irs.gov

304–267–3367 — TDD
(Telecommunication Device for the Deaf)

304–264–5602 — Fax Machine

Electronic Filing — FIRE system
http://fire.irs.gov

TO OBTAIN FORMS:

1–800–TAX–FORM (1–800–829–3676)

www.irs.gov — IRS Website access to forms

Sec. 4. Filing Requirements

.01 Section 6011(e)(2)(A) of the Internal Revenue Code requires that any person, including corporations, partnerships, individuals, estates, and trusts, required to file 250 or more information returns must file such returns on magnetic media.

.02 The filing requirements apply separately to both original and corrected returns.

.03 Filing electronically through the FIRE system with IRS/ECC-MTB fulfills the magnetic media filing requirement.

.04 The above requirements do not apply if you establish undue hardship (see Part A, Sec. 5).

Sec. 5. Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically

.01 If an employer is required to file on magnetic media but fails to do so (or fails to file electronically, in lieu of magnetic media filing) and does not have an approved waiver on record, the employer will be subject to a penalty of $50 per return in excess of 250.

.02 If employers are required to file original or corrected returns on magnetic media, but such filing would create a hardship, they may request a waiver from these filing requirements by submitting Form 8508, Request for Waiver From Filing Information Returns Electronically/Magnetically, to IRS/ECC-MTB.

.03 Even though an employer may submit as many as 250 corrections on paper, IRS encourages electronically or magnetically submitted corrections. Once the 250 threshold has been met, filers are required to submit any additional returns electronically or magnetically. However, if a waiver for an original filing is approved, any corrections for the same type of returns will be covered under this waiver.

.04 Generally, only the employer may sign the Form 8508. A transmitter may sign if given power of attorney; however, a letter signed by the employer stating this fact must be attached to the Form 8508.

.05 A transmitter must submit a separate Form 8508 for each employer. Do not submit a list of employers.

.06 All information requested on the Form 8508 must be provided to IRS for the request to be processed.

.07 The waiver, if approved, will provide exemption from magnetic media filing for the current tax year only. Employers may not apply for a waiver for more than one tax year at a time; application must be made each year a waiver is necessary.

.08 Form 8508 may be photocopied or computer-generated as long as it contains all the information requested on the original form.

.09 Filers are encouraged to submit Form 8508 to IRS/ECC-MTB at least 45 days before the due date of the returns.

.10 File Form 8508 for Forms W–2 with IRS/ECC-MTB, not SSA.

.11 Waivers are evaluated on a case-by-case basis and are approved or denied based on criteria set forth under section 6011(e) of the Internal Revenue Code. The transmitter must allow a minimum of 30 days for IRS/ECC-MTB to respond to a waiver request.

.12 If a waiver request is approved, the transmitter should keep the approval letter on file.

.13 An approved waiver from filing Forms 8027 on magnetic media does not provide exemption from all filing. The employer must timely file Form 8027 on acceptable paper forms with the Cincinnati Service Center. **The transmitter should also send a copy of the approved waiver to the Cincinnati Service Center where the paper returns are filed.**

Sec. 6. Form 4419, Application for Filing Information Returns Electronically/Magnetically

.01 For the purposes of this revenue procedure, the EMPLOYER is the organization supplying the information and the TRANSMITTER is the organization preparing the electronic/magnetic file and/or sending the file to IRS/ECC-MTB. The employer and the transmitter may be the same entity. Employers or their transmitters are required to complete Form 4419, Application for Filing Information Returns Electronically/Magnetically.

.02 Form 4419 can be submitted at any time during the year; however, it should be submitted to IRS/ECC-MTB at least 30 days before the due date of the return(s). IRS will act on an application and notify the applicant, in writing, of authorization to file. A five-character alpha/numeric Transmitter Control Code (TCC) will be assigned and included in an acknowledgment letter within 15 to 45 days of receipt of the application. Electronic/magnetic returns may not be filed with IRS until the application has been approved and a TCC assigned. Include your TCC in any correspondence with IRS/ECC-MTB.

.03 If you file information returns other than Form 8027 electronically/magnetically, you must obtain a separate TCC for those types of returns. The TCC assigned for Forms 8027 is to be used for the processing of these forms only.

.04 After you have received approval to file electronically/magnetically, you do not need to reapply each year; however, notify IRS in writing if:

(a) You change your name or the name of your organization, so that your files may be updated to reflect the proper name;

(b) You discontinue filing for two years (your TCC may have been reassigned).

.05 IRS/ECC-MTB encourages filers who plan to submit for multiple employers to submit one application and to use one TCC for all employers.

.06 Only employers or transmitters using equipment compatible with IRS equipment will have their application approved.

.07 If your electronic/magnetic media files have been prepared for you in the past by a transmitter, and you now have computer equipment compatible with that of IRS and wish to prepare your own files, you must request your own five-character alpha/numeric TCC by filing an application, Form 4419, as described in Sec. 6.02.

Sec. 7. Test Files

.01 IRS/ECC-MTB encourages new filers to submit test files for review in advance of the filing season. Employers or transmitters must be approved to file electronically/magnetically before a test file is submitted (See Part A, Sec. 6 for application procedures.)

.02 All test files must be submitted between November 1 and February 15 of the year before the returns are due. *If you are filing **electronically**, you may submit a test file through February 15 of the year the returns are due*.

Sec. 8. Filing Forms 8027 Electronically/Magnetically

.01 Form 4804, Transmittal of Information Returns Reported Magnetically, must accompany **all** tape cartridge shipments.

.02 The employer **MUST** sign Form 4804; however, an agent (transmitter, service bureau, paying agent, or disbursing agent) may sign Form 4804 for the employer. To do this, the agent must have the authority to sign for the employer under an agency agreement (either oral, written, or implied) that is valid under the state law and must add to his or her signature the caption "For: (name of employer)".

NOTE: Failure to sign the Form 4804 may delay processing or could result in your file being returned to you unprocessed.

.03 Although a duly authorized agent may sign the Form 4804, the employer is responsible for the accuracy of the Form 4804 and the returns filed. The employer will be liable for penalties for failure to comply with filing requirements.

.04 Be sure to include Form 4804 or computer-generated substitutes with your tape cartridge shipment. **DO NOT MAIL YOUR TAPE CARTRIDGE AND THE TRANSMITTAL DOCUMENTS SEPARATELY.**

.05 Indicate on Form 4804 in block 8 the total number of establishments being reported in this shipment. This figure should match the total number of records in your magnetic file.

.06 DO NOT SUBMIT THE SAME INFORMATION ON PAPER FORMS THAT YOU SUBMIT ELECTRONICALLY/MAGNETICALLY, SINCE THIS WOULD RESULT IN DUPLICATE FILING. This does not mean that corrected documents are not to be filed. If a return has been prepared and submitted improperly, you must file a corrected return as soon as possible. Refer to Part A, Sec. 14 for requirements and instructions for filing corrected returns.

.07 If an allocation of tips is based on a good faith agreement, a copy of this agreement must accompany the submission.

.08 An employer with establishments in more than one IRS district can apply to one of the district offices for a determination letter which would cover all establishments. The request should be sent to the district with the most establishments. Employers with establishments in more than one IRS district should follow the procedures in Sec. 31.6053–3(h)(4) of the Employment Tax Regulations.

.09 Before submitting your magnetic file, include the following:

(a) A **signed** Form 4804, Transmittal of Information Returns Reported Magnetically.

(b) Your tape cartridge should be labeled with an external identifying label. Notice 210 describes the information which should be included on this self-prepared label.

(c) On the outside of the shipping container, affix the label, IRB Special Projects. This label is included in this publication.

Note: See Part B for electronic submission requirements.

.10 IRS/ECC-MTB will not pay or accept "Collect on Delivery" or "Charged to IRS" shipments of reportable tax information that an individual or organization is legally required to submit.

Sec. 9. Due Dates

.01 Electronic/magnetic reporting to IRS for Form 8027 must be on a calendar year basis. The due date for paper or magnetically reported Forms 8027 is the last day of February. However, Forms 8027 filed **electronically** are due March 31.

.02 If the due date falls on a Saturday, Sunday, or legal holiday, filing Form 8027 on the next day that is not a Saturday, Sunday, or legal holiday will be considered timely.

.03 Tape cartridge returns postmarked by the United States Postal Service (USPS) on or before the last day of February, and delivered by United States mail to IRS/ECC-MTB after the due date, are treated as timely under the "timely mailing as timely filing" rule. Notice 2002–62, 2002–2 C.B. 574, provides rules for determining the date that is treated as the postmark date. A similar rule applies to items delivered by private delivery services (PDSs) designated by the IRS. A PDS must be designated by the IRS before it will qualify for the timely mailing rule. (See **Note**.) Notice 2004–83, 2004–2 C.B. 1030, provides the list of designated PDSs. Designation is effective until the IRS issues a revised list. For items delivered by a non-designated PDS, the actual date of receipt by IRS/ECC-MTB will be used as the filing date. For items delivered by a designated PDS, but through a type of service not designated in Notice 2004–83, the actual date of receipt by IRS/ECC-MTB will be used as the filing date.

Note: Due to security regulations at ECC, the Internal Revenue police officers will only accept media from PDSs or couriers from *8:00 a.m. to 3:00 p.m.*, Monday through Friday.

Sec. 10. State Abbreviations

.01 The following state and U.S. territory abbreviations are to be used when developing the state code portion of address fields.

State	Code	State	Code	State	Code
Alabama	AL	Kentucky	KY	No. Mariana Islands	MP
Alaska	AK	Louisiana	LA	Ohio	OH
American Samoa	AS	Maine	ME	Oklahoma	OK
Arizona	AZ	Marshall Islands	MH	Oregon	OR
Arkansas	AR	Maryland	MD	Pennsylvania	PA
California	CA	Massachusetts	MA	Puerto Rico	PR
Colorado	CO	Michigan	MI	Rhode Island	RI
Connecticut	CT	Minnesota	MN	South Carolina	SC
Delaware	DE	Mississippi	MS	South Dakota	SD
District of Columbia	DC	Missouri	MO	Tennessee	TN
Federated States of Micronesia	FM	Montana	MT	Texas	TX
Florida	FL	Nebraska	NE	Utah	UT
Georgia	GA	Nevada	NV	Vermont	VT
Guam	GU	New Hampshire	NH	Virginia	VA
Hawaii	HI	New Jersey	NJ	(U.S.) Virgin Islands	VI
Idaho	ID	New Mexico	NM	Washington	WA
Illinois	IL	New York	NY	West Virginia	WV
Indiana	IN	North Carolina	NC	Wisconsin	WI
Iowa	IA	North Dakota	ND	Wyoming	WY
Kansas	KS				

.02 Filers must adhere to the city, state, and ZIP Code format for U.S. addresses. This also includes American Samoa, Federated States of Micronesia, Guam, Marshall Islands, Northern Mariana Islands, Puerto Rico, and the U.S. Virgin Islands.

Sec. 11. Extension of Time

.01 An extension of time to file may be requested for Form 8027.

.02 Form 8809, Application for Extension of Time To File Information Returns, should be submitted to IRS/ECC-MTB. This form may be used to request an extension of time to file information returns submitted on paper, electronically or magnetically.

.03 Filers requesting an extension of time for multiple employers may submit one Form 8809 and attach a list of the employer names and their Taxpayer Identification Numbers (TINs) (EIN or SSN). **The listing must be attached to ensure the extension is recorded for all employers.** Form 8809 may be computer-generated or photocopied. Be sure that all the pertinent information is included.

.04 Requests for extensions of time for multiple employers will be responded to with one approval letter, accompanied by a list of employers covered under that approval.

.05 As soon as it is apparent that an extension of time to file is needed, Form 8809 may be submitted. When granted, the extension will be for 30 days. It will take a minimum of 30 days for IRS/ECC-MTB to respond to an extension request. Under certain circumstances, a request for an extension of time could be denied. When a denial letter is received, any additional or necessary information may be resubmitted within 20 days. When requesting an extension of time, **do not** hold your files waiting for a response.

.06 While very difficult to obtain, if an additional extension of time is needed, a second Form 8809 must be submitted before the end of the initial extension period. Line 7 on the form should be checked to indicate that an additional extension is being requested. A second 30-day extension will be approved only in cases of extreme hardship or catastrophic events.

.07 Form 8809 must be postmarked no later than the due date of the return for which an extension is requested. If requesting an extension of time to file several types of forms, use one Form 8809, but the Form 8809 must be postmarked no later than the earliest due date. For example, if requesting an extension of time to file both Forms 8027 and 5498, submit Form 8809 postmarked on or before the last day of February.

.08 If an extension request is approved, the approval letter should be kept on file. The approval letter or copy of the approval letter for extension of time should **not** be sent to IRS/ECC-MTB with the electronic/magnetic file. When submitting Form 8027 on **paper only** to the Cincinnati Service Center, attach a copy of the approval letter. If an approval letter has not been received, send a copy of the timely filed Form 8809.

.09 Request an extension for only one tax year.

.10 The extension request must be signed by the employer or a person who is duly authorized to sign a return, statement or other document for the employer.

.11 Failure to properly complete and sign the Form 8809 may cause delays in processing the request or result in a denial. Carefully read and follow the instructions on the back of the Form 8809.

.12 Form 8809 may be obtained by calling **1–800–TAX–FORM (1–800–829–3676) or downloading from www.irs.gov.**

Note: An extension of time to file is not an extension to issue Form W–2 to the employee.

.13 Request an extension of time to furnish the statements to recipients of Forms W–2 by submitting a letter to IRS/ECC-MTB (See Part A, Sec. 3.06) containing the following information:

(a) Employer name
(b) EIN
(c) Address
(d) Type of return (W–2)
(e) Specify that the extension request is to provide W–2 statements to recipients.
(f) Reason for delay
(g) Signature of employer or person duly authorized.

Requests for an extension of time to furnish the statements for Forms W–2 to recipients are not automatically approved; however, if approved, generally an extension will allow a maximum of 30 additional days from the due date to furnish the statements to the recipients. The request must be postmarked no later than the date on which the statements are due to the recipients.

Sec. 12. Processing of Information Returns Electronically/Magnetically

.01 All data received at the IRS/ECC-MTB for processing will be given the same protection as individual returns (Form 1040). IRS/ECC-MTB will process your electronic/magnetic files to ensure the records were formatted and coded according to this revenue procedure.

.02 If the tape cartridge is formatted incorrectly, you will receive a letter of explanation along with a Media Tracking Slip (Form 9267). When a replacement file is requested, it is because IRS/ECC-MTB encountered errors (not limited to format) and was unable to process the file. Open all packages immediately.

.03 Magnetic files must be corrected and returned with the Media Tracking Slip (Form 9267) to IRS/ECC-MTB within 45 days from the date of the letter from IRS/ECC-MTB requesting the replacement file. A penalty for failure to file correct information returns by the due date will be assessed if the file is not corrected and replaced within the 45 days **or if the incorrect file is returned by IRS/ECC-MTB for replacement more than two times.** A penalty for intentional disregard of filing requirements will be assessed if a replacement file is not received.

.04 Files will not be returned to you after successful processing. Therefore, if you want proof that IRS/ECC-MTB received your shipment, you may use a carrier that provides proof of delivery.

.05 To distinguish between a correction and a replacement, the following definitions are provided:

(a) A **correction** is an information return submitted by the employer/transmitter to correct an information return that was previously submitted to and successfully processed by IRS, but contained erroneous information.

Note: Corrections should only be made to forms that have been submitted incorrectly, not the entire file.

(b) A **replacement** is an information return file sent by the employer/transmitter **at the request** of IRS/ECC-MTB because of errors encountered while processing the filer's original file or correction file.

Note 1: Filers should never send anything to IRS/ECC-MTB marked "Replacement" unless IRS/ECC-MTB requested a replacement in writing or via the FIRE System.

Note 2: ***IRS/ECC-MTB no longer accepts 3½-inch diskettes for filing Form 8027.***

Sec. 13. Penalties

.01 The Revenue Reconciliation Act of 1989 changed the penalty provisions for any documents, including corrections, which are filed after the original filing date for the return. The penalty for failure to file correct information returns is "time sensitive," in that prompt correction of failures to file, or prompt correction of errors on returns that were filed, can lead to reduced penalties.

- The penalty generally is $50 for each information return that is not filed, or is not filed correctly, by the prescribed filing date, with a maximum penalty of $250,000 per year ($100,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000). The penalty generally is reduced to:
- $30 for each failure to comply if the failure is corrected more than 30 days after the return was due, but on or before August 1 of the calendar year in which the return was due, with a maximum penalty of $150,000 per year ($50,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000).
- $15 for each failure to comply if the failure is corrected within 30 days after the date the return was due, with a maximum penalty of $75,000 per year ($25,000 for certain small businesses with average annual gross receipts, over the most recent 3-year period, not in excess of $5,000,000).

.02 Penalties can be waived if failures were due to reasonable cause and not to willful neglect. In addition, section 6721(c) of the Code provides a de minimis rule that if:

(a) information returns have been filed but were filed with incomplete or incorrect information, and

(b) the failures are corrected on or before August 1 of the calendar year in which the returns were due, then the penalty for filing incorrect returns (but not the penalty for filing late) will not apply to the greater of 10 returns or one-half of 1 percent of the total number of information returns you are required to file for the calendar year.

.03 Intentional Disregard of Filing Requirements — If any failure to file a correct information return is due to intentional disregard of the filing and correct information requirements, the penalty is at least $100 per information return with no maximum penalty.

Sec. 14. Corrected Returns, Substitute Forms, and Computer-Generated Forms

.01 If returns must be corrected, approved electronic/magnetic filers must provide such corrections electronically/magnetically for 250 or more forms. If your information is filed electronically/magnetically, corrected returns are identified by using the "Corrected 8027 Indicator" in field position 370 of the employer record. Form 4804 must accompany the tape cartridge shipment, and the box for correction should be marked in Block 1 of the form. (See Part A, Sec. 12.05 for the definition of corrections.)

.02 If corrections are not submitted electronically/magnetically, employers must submit them on official Forms 8027. Substitute forms that have been previously approved by IRS, or computer-generated forms that are exact facsimiles of the official form (except for minor page size or print style deviations), may be submitted without obtaining IRS approval before using the form.

.03 Employers/establishments may send corrected paper Forms 8027 to IRS at the address shown in Part A, Sec. 15.01. Corrected paper returns are identified by marking the "AMENDED" check box on Form 8027.

Sec. 15. Effect on Paper Returns

.01 If you are filing more than one paper Form 8027, you must attach a completed Form 8027–T, Transmittal of Employer's Annual Information Return of Tip Income and Allocated Tips, to the Forms 8027 and send to:

Internal Revenue Service Center
Cincinnati, OH 45999

IRS/ECC-MTB processes Forms 8027 submitted electronically/magnetically only. Do not send paper Forms 8027 to IRS/ECC-MTB.

.02 If part of a submission is filed electronically/magnetically and the rest of the submission is filed on paper Forms 8027, send the paper forms to the Cincinnati Service Center. For example, you filed your Forms 8027 electronically/magnetically with IRS/ECC-MTB, and later you found that some of the forms you filed need correcting. Because of the low volume of corrections, you submit the corrections on paper Forms 8027. You must send these corrected Forms 8027 along with Form 8027-T to the Cincinnati Service Center.

Sec. 16. Definition of Terms

ELEMENT	DESCRIPTION
Correction	A correction is an information return submitted by the employer/transmitter to correct an information return that was previously submitted to and successfully processed by IRS, but contained erroneous information.
EIN	A nine-digit Employer Identification Number which has been assigned by IRS to the reporting entity.
Employees hours worked	The average number of employee hours worked per business day during a month is figured by dividing the total hours worked during the month by all your employees who are employed in a food or beverage operation **by** the average number of days in the month that each food or beverage operation at which these employees worked was open for business.
Employer	The organization supplying their information. Use the same name and EIN you used on your Forms W–2 and Forms 941.
Establishment	A large food or beverage establishment that provides food or beverage for consumption on the premises; where tipping is a customary practice; and where there are normally more than 10 employees who work more than 80 hours on a typical business day during the preceding calendar year.
File	For the purpose of this revenue procedure, a file is the 8027 information submitted electronically/magnetically by an Employer or Transmitter.
More than 10 employees	An employer is considered to have more than 10 employees on a typical business day during the calendar year if half the sum of: the average number of employee hours worked per business day in the calendar month in which the aggregate gross receipts from food and beverage operations were greatest, **plus** the average number of employee hours worked per business day in the calendar month in which the total aggregate gross receipts from food and beverage operations were the least, **equals** more than 80 hours.
Replacement	A replacement is an information return file sent by the employer/transmitter **at the request** of IRS/ECC-MTB because of errors encountered while processing the filer's original file or correction file.
Transmitter	Person or organization preparing electronic/magnetic file(s). May be employer or agent of employer.
Transmitter Control Code (TCC)	A five-character alpha/numeric code assigned by IRS to the transmitter prior to actual filing electronically/magnetically. This number is inserted in the record and must be present. An application (Form 4419) must be filed with IRS to receive this number.

PART B. ELECTRONIC FILING SPECIFICATIONS

Note: The FIRE System is now on the Internet at http://fire.irs.gov . It is no longer a dial-up connection. The FIRE System DOES NOT provide fill-in forms. Filers must program files according to the Record Layout Specifications contained in this publication.

Sec. 1. General

.01 Electronic filing of Forms 8027 information returns, originals and replacements, is offered as an alternative to tape cartridge or paper filing. Filing electronically will fulfill the magnetic media requirements for those payers who are required to file magnetically. Payers who are under the filing threshold requirement are encouraged to file electronically. If the original file was sent magnetically,

but IRS/ECC-MTB has requested a replacement file, the replacement may be transmitted electronically. Also, if the original file was submitted via tape cartridge, any corrections may be transmitted electronically.

.02 All electronic filing of information returns are received at IRS/ECC-MTB via the FIRE (Filing Information Returns Electronically) System. To connect to the FIRE System, point your browser to http://fire.irs.gov. The system is designed to support the electronic filing of information returns only.

.03 The electronic filing of information returns is not affiliated with any other IRS electronic filing programs. Filers must obtain separate approval to participate in each program. Only inquiries concerning electronic filing of information returns should be directed to IRS/ECC-MTB.

.04 Files submitted to IRS/ECC-MTB electronically must be in standard ASCII code. Do not send tape cartridges or paper forms with the same information as electronically submitted files. This would create duplicate reporting resulting in penalty notices.

.05 The record format is the same for both electronically or magnetically filed records. See Part C, Filing Specifications and Record Layout.

Sec. 2. Advantages of Filing Electronically

Some of the advantages of filing electronically are:

(1) Security – Secure Socket Layer (SSL) 128-bit encryption.

(2) Results available within 20 business days regarding the acceptability of the data transmitted. It is the filer's responsibility to log into the system and check results.

(3) Better customer service due to on-line availability of transmitter's files for research purposes.

(4) Electronically filed Forms 8027 have a later due date of March 31.

Sec. 3. Electronic Filing Approval Procedure

.01 Filers must obtain a Transmitter Control Code (TCC) prior to submitting files electronically. Filers who currently have a TCC for magnetic media filing of Form 8027 may use their assigned TCC for electronic filing. Refer to Part A, Sec. 6, for information on how to obtain a TCC.

.02 Once a TCC is obtained, electronic filers assign their own user ID, password and PIN (Personal Identification Number) and do not need prior or special approval. See Part B, Sec. 6, for more information on the PIN.

.03 If a filer is submitting files for more than one TCC, it is not necessary to create a separate logon and password for each TCC.

.04 For all passwords, it is the user's responsibility to remember the password and not allow the password to be compromised. Passwords are user assigned at first logon and must be 8 alpha/numeric characters containing at least 1 uppercase, 1 lowercase, and 1 numeric. However, filers who forget their password or PIN, can call **toll-free 1–866–455–7438** for assistance. The FIRE System may require users to change their passwords on a yearly basis.

Sec. 4. Test Files

.01 Filers are not required to submit a test file; however, the submission of a test file is encouraged for all new electronic filers to test hardware and software. If filers wish to submit an electronic test file for Tax Year *2006* (returns to be filed in *2007*), it **must** be submitted to IRS/ECC-MTB **no earlier than** November 1, 2006, and **no later than** February 15, 2007.

.02 Filers who encounter problems while transmitting the electronic test file can contact IRS/ECC-MTB **toll-free 1–866–455–7438** for assistance.

.03 Filers must verify the status of the transmitted test data by going to http://fire.irs.gov and verifying the status of their file by clicking on CHECK FILE STATUS. This information will be available within 20 business days after the transmission is received by IRS/ECC-MTB.

.04 Form 4804 is not required for test files submitted electronically. See Part B, Sec. 6.

Sec. 5. Electronic Submissions

.01 Electronically filed information may be submitted to IRS/ECC-MTB 24 hours a day, 7 days a week. Technical assistance will be available Monday through Friday between 8:30 a.m. and 4:30 p.m. Eastern time by calling **toll-free 1–866–455–7438.**

.02 The FIRE System will be down from 2 p.m. December 21, 2006 through January 2, 2007. This allows IRS/ECC-MTB to update its system to reflect current year changes.

.03 If you are sending files larger than 10,000 records electronically, data compression is encouraged. If you are considering sending files larger than 5 million records, please contact IRS/ECC-MTB for specifics. WinZip and PKZip are the only acceptable compression packages. IRS/ECC-MTB cannot accept self-extracting zip files or compressed files containing multiple files. The time required to transmit information returns electronically will vary depending upon the type of connection to the internet and if data compression is used. **The time required to transmit a file can be reduced by as much as 95 percent by using compression.**

.04 Transmitters may create files using self assigned files name(s). Files submitted electronically will be assigned a new unique file name by the FIRE System. The filename assigned by the FIRE System will consist of submission type (ORIG [original], TEST [test], CORR [correction], and REPL [replacement]), the filer's TCC and a four-digit number sequence. The sequence number will be incremented for every file sent. For example, if it is your first original file for the calendar year and your TCC is 44444, the IRS assigned filename would be ORIG.44444.0001. **Record the filename.** This information will be needed by ECC-MTB to identify the file, if assistance is required.

.05 If a file was submitted timely and is bad, the filer will have up to 60 days from the day the file was sent to transmit an acceptable file. If an acceptable file is not received within 60 days, then the payer could be subject to late filing penalties. These time lines only apply to files originally submitted electronically.

.06 The following definitions have been provided to help distinguish between a correction and a replacement:

- A **correction** is an information return submitted by the transmitter to correct an information return that was previously submitted to and successfully processed by IRS/ECC-MTB, but contained erroneous information. **(See Note.)**

Note: Corrections should only be made to forms that have been submitted incorrectly, not the entire file.

- A **replacement** is an information return file sent by the filer because the CHECK FILE STATUS option on the FIRE System indicated the original/replacement file was bad. After the necessary changes have been made, the file must be transmitted through the FIRE System. **(See Note.)**

Note: Filers should never transmit anything to IRS/ECC-MTB as a "Replacement" file unless the CHECK FILE STATUS option on the FIRE System indicates the file is bad.

.07 The TCC in the Transmitter "T" Record must be the TCC used to transmit the original file; otherwise, the file will be considered an error.

Sec. 6. PIN Requirements

.01 Filers will be prompted to create a PIN consisting of 10 numeric characters when establishing their initial logon name and password.

.02 The PIN is required each time an ORIGINAL, CORRECTION, or REPLACEMENT file is sent electronically and is permission to release the file. It is not needed for a TEST file. An authorized agent may enter their PIN, however, the payer is responsible for the accuracy of the returns. The payer will be liable for penalties for failure to comply with filing requirements. If you forget your PIN, please call **toll-free 1–866–455–7438** for assistance.

Sec. 7. Electronic Filing Specifications

.01 The FIRE System is designed exclusively for the filing of Forms 8027, 1098, 1099, 5498, W–2G, and 1042–S.

.02 A transmitter must have a TCC (see Part A, Sec. 6) before a file can be transmitted. A TCC assigned for magnetic media filing should also be used for electronic filing.

.03 The results of the electronic transmission will be available in the CHECK FILE STATUS area of the FIRE System within 20 business days. It is the filer's responsibility to verify the acceptability of files submitted by selecting the CHECK FILE STATUS option.

Sec. 8. Connecting to the FIRE System

.01 Point your browser to http://fire.irs.gov to connect to the FIRE System.

.02 When running Norton Internet Security or similar software, you may need to disable this feature if your file transfer does not complete properly.

.03 Before connecting, have your TCC and EIN available.

.04 Your browser must support SSL 128-bit encryption.

.05 Your browser must be set to receive "cookies". Cookies are used to preserve your User ID status.

First time connection to The FIRE System (If you have logged on previously, skip to Subsequent Connections to the FIRE System.)

Click ***"Create New Account".***
Fill out the registration form and click ***"Submit"***.
Enter your ***User ID*** (most users logon with their first and last name).

First time connection to The FIRE System (If you have logged on previously, skip to Subsequent Connections to the FIRE System.) – Continued.

Enter and verify your ***password*** (the password is user assigned and must be 8 alpha/numerics, containing at least 1 uppercase, 1 lowercase and 1 numeric). FIRE may require you to change the password once a year.
Click ***"Create".***
If you receive the message **"Account Created"**, click ***"OK".***
Enter and verify your 10-digit self-assigned PIN (Personal Identification Number).
Click ***"Submit".***
If you receive the message **"Your PIN has been successfully created!",** click ***"OK".***
Read the bulletin(s) and/or click ***"Start the FIRE application".***

Subsequent connections to The FIRE System

Click ***"Log On".***
Enter your ***User ID*** (most users logon with their first and last name).
Enter your ***password*** (the password is user assigned and is case sensitive).

Uploading your file to the FIRE System

At Menu Options:
Click ***"Send Information Returns"***
Enter your ***TCC:***
Enter your ***EIN:***
Click ***"Submit".***

The system will then display the company name, address, city, state, ZIP Code, phone number, contact and email address. This information will be used to contact or send correspondence (if necessary) regarding this transmission. Update as appropriate and/or Click ***"Accept"***.

Click one of the following:
Original File
Correction File
Test File *(This option will only display from 11/1/2006 – 2/15/2007.)*
Replacement File (if you select this option, select one of the following):

Electronic Replacement (file was originally transmitted on this system)
Click the file to be replaced.

Magnetic Media Replacement
Enter the alpha character from Form 9267, Media Tracking Slip, that was sent with the request for replacement file. Click ***"Submit"***.

Enter your 10-digit PIN.
Click ***"Submit".***
Click ***"Browse"*** to locate the file and open it.
Click ***"Upload".***

When the upload is complete, the screen will display the total bytes received and tell you the name of the file you just uploaded.

If you have more files to upload for that TCC:
Click ***"File Another?";*** otherwise,
Click ***"Main Menu".***

It is your responsibility to check the acceptability of your file; therefore, be sure to check back into the system in 20 business days using the CHECK FILE STATUS option.

Checking your FILE STATUS

At the Main Menu:

Click ***"Check File Status".***
Enter your ***TCC:***
Enter your ***EIN:***
Click ***"Search".***

If "Results" indicate:

"Good" — File has been released to our mainline processing.

"Bad" — Correct the errors and timely resubmit the file as a "replacement".

"Not yet processed" — File has been received, but we do not have results available yet. Please check back in a few days.

Click on the desired file for a detailed report of your transmission.
When you are finished, click on ***Main Menu.***
Click ***"Log Out".***
Close your Web Browser.

Sec. 9. Common Problems and Questions Associated with Electronic Filing

.01 The following are the major errors associated with electronic filing:

NON-FORMAT ERRORS

1. Transmitter does not check the FIRE System to determine file acceptability.

The results of your file transfer are posted to the FIRE System within 20 business days. It is your responsibility to verify file acceptability and, if the file contains errors, you can get an online listing of the errors. Date received and number of payee records are also displayed.

2. Replacement file is not submitted timely.

If your file is bad, correct the file and timely resubmit as a replacement.

3. Transmitter compresses several files into one.

Only compress one file at a time. For example, if you have 10 uncompressed files to send, compress each file separately and send 10 separate compressed files.

4. Transmitter sends an original file that is good, and then sends a correction file for the entire file even though there are only a few changes.

The correction file, containing the proper coding, should only contain the records needing correction, not the entire file.

5. File is formatted as EBCDIC.

All files submitted electronically must be in standard ASCII code.

6. Transmitter has one TCC number, but is filing for multiple companies, which EIN should be used when logging into the system to send the file?

When sending the file electronically, you will need to enter the EIN of the company assigned to the TCC. When you upload the file, it will contain the EINs for the other companies that you are filing for. This is the information that will be passed forward.

7. Transmitter sent the wrong file, what should be done?

Call us as soon as possible **toll-free 1–866–455–7438.** We may be able to stop the file before it has been processed. **Please do not send a replacement for a file that is marked as a good file.**

PART C. FILING SPECIFICATIONS AND RECORD LAYOUT

.01 Transmitters should be consistent in the use of recording codes and density on files. If the media does not meet these specifications, IRS/ECC-MTB will request a replacement file. Filers are encouraged to submit a test prior to submitting the actual file. Contact IRS/ECC-MTB **toll-free 1–866–455–7438, extension 6** for further information.

Note: For tax year 2008 filed in calendar year 2009, IRS/ECC-MTB will no longer accept tape cartridges. Electronic filing will be the ONLY acceptable method for filing Form 8027.

Sec. 1. Tape Cartridge Specifications

.01 In most instances, IRS/ECC-MTB can process tape cartridges that meet the following specifications:

(a) Must be IBM 3480, 3490, 3490E, 3590, or 3590E.

(b) Must meet American National Standard Institute (ANSI) standards, and have the following characteristics:

(1) Tape cartridges must be 1/2-inch tape contained in plastic cartridges that are approximately 4-inches by 5-inches by 1-inch in dimension.

(2) Magnetic tape must be chromium dioxide particle based 1/2-inch tape.

(3) Cartridges must be 18-track, 36-track, 128-track or 256-track parallel **(See Note.)**

(4) Cartridges will contain 37,871 CPI, 75,742 CPI, or 3590 CPI (characters per inch).

(5) Mode will be full function.

(6) The data may be compressed using EDRC (Memorex) or IDRC (IBM) compression.

(7) Either EBCDIC (Extended Binary Coded Decimal Interchange Code) or ASCII (American Standard Coded Information Interchange) may be used.

.02 The tape cartridge records defined in this Revenue Procedure may be blocked subject to the following:

(a) A block **must not** exceed 32,760 tape positions.

(b) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9s; however, the last block of the file may be filled with 9s or truncated. **Do not pad a block with blanks.**

(c) All records, except the header and trailer labels, may be blocked or unblocked. A record may not contain any control fields or block descriptor fields, which describe the length of the block or the logical records within the block. The number of logical records within a block (the blocking factor) must be constant in every block with the exception of the last block, which may be shorter (see item (b) above). The block length must be evenly divisible by 420.

(d) Records may not span blocks.

.03 Tape cartridges may be labeled or unlabeled.

.04 For the purposes of this Revenue Procedure, the following must be used:

Tape Mark:

(a) Signifies the physical end of the recording on tape.

(b) For even parity, use BCD configuration 001111 (8421).

(c) May follow the header label and precede and/or follow the trailer label.

Note: Filers should indicate on the external media label whether the cartridge is 18-track, 36-track, 128-track or 256-track.

Sec. 2. Record Format and Layout

FORM 8027 RECORD FORMAT			
Field Position	**Field Title**	**Length**	**Description and Remarks**
1	Establishment Type	1	**Required.** This number identifies the kind of establishment. Enter the number which describes the type of establishment, as shown below: 1. for an establishment that serves evening meals only (with or without alcoholic beverages). 2. for an establishment that serves evening meals and other meals (with or without alcoholic beverages). 3. for an establishment that serves only meals other than evening meals (with or without alcoholic beverages). 4. for an establishment that serves food, if at all, only as an incidental part of the business of serving alcoholic beverages.
2–6	Establishment Serial Numbers	5	**Required.** These five-digit Serial Numbers are for identifying individual establishments of an employer reporting under the same EIN. The employer shall assign each establishment a unique number. **Numeric characters only.**
7–46	Establishment Name	40	**Required.** Enter the name of the establishment. Left-justify and fill unused positions with blanks. **Allowable characters are alphas, numerics, blanks, hyphens, ampersands, and slashes.**
47–86	Establishment Street Address	40	**Required.** Enter the mailing address of the establishment. Street address should include number, street, apartment or suite number (use P O Box only if mail is not delivered to street address). Left-justify and blank fill.
Note: The only allowable characters are alphas, numeric characters, blanks, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.			
87–111	Establishment City	25	**Required.** Enter the city, town, or post office. Left-justify and blank fill.
Note: The only allowable characters are alphas, numeric characters, blanks, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.			
112–113	Establishment State	2	**Required.** Enter the state code from the state abbreviations table in Part A, Sec. 10.
114–122	Establishment ZIP Code	9	**Required.** Enter the complete nine-digit ZIP Code of the establishment. If using a five-digit ZIP Code, left-justify the five-digit ZIP Code and fill the remaining four positions with blanks.
Note: Must be nine numeric characters or 5 numeric characters and four blanks. Do not enter the dash.			
123–131	Employer Identification Number	9	**Required.** Enter the nine-digit number assigned to the employer by IRS. **Do not enter hyphens, alphas, all 9s or all zeros.**
132–171	Employer Name	40	**Required.** Enter the name of the employer as it appears on your tax forms (e.g., Form 941). Any extraneous information must be deleted. Left-justify and blank fill. **Allowable characters are alphas, numerics, blanks, hyphens, ampersands, and slashes.**

FORM 8027 RECORD FORMAT			
Field Position	**Field Title**	**Length**	**Description and Remarks**
172–211	Employer Street Address	40	**Required.** Enter mailing address of employer. Street address should include number, street, apartment or suite number (use P O Box only if mail is not delivered to street address). Left-justify and blank fill.
Note: The only allowable characters are alphas, numeric characters, blanks, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the address 210 N. Queen St., Suite #300 must be entered as 210 N Queen St Suite 300.			
212–236	Employer City	25	**Required.** Enter the city, town, or post office. Left-justify and blank fill.
Note: The only allowable characters are alphas, numeric characters, blanks, ampersands, hyphens and slashes. Punctuation such as periods and commas are not allowed and will cause your file to be returned. For example, the city St. Louis must be entered as St Louis.			
237–238	Employer State	2	**Required.** Enter the state code from the state abbreviations table in Part A, Sec. 10.
239–247	Employer ZIP Code	9	**Required.** Enter the complete nine-digit ZIP Code of the employer. If using a five-digit ZIP Code, left-justify the five-digit ZIP Code and fill the remaining four positions with blanks.
Note: Must be nine numeric characters or 5 numeric characters and four blanks. Do not enter the dash.			
248–259	Charged Tips	12	**Required.** Enter the total amount of tips that are shown on charge receipts for the calendar year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
260–271	Charged Receipts	12	**Required.** Enter the total sales for the calendar year other than carry-out sales or sales with an added service charge of 10 percent or more, that are on charge receipts with a charged tip shown. This includes credit card charges, other credit arrangements, and charges to a hotel room unless the employer's normal accounting practice consistently excludes charges to a hotel room. Do not include any state or local taxes in the amount reported. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
272–283	Service Charge Less Than 10 Percent	12	**Required.** Enter the total amount of service charges less than 10 percent added to customer's bills and were distributed to your employees for the calendar year. In general, service charges added to the bill are not tips since the customer does not have a choice. These service charges are treated as wages and are included on Form W–2. For a more detailed explanation, see Rev. Rul. 69–28, 1969–1 C.B. 270. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
284–295	Indirect Tips Reported	12	**Required.** Enter the total amount of tips reported by indirectly tipped employees (e.g., bussers, service bartenders, cooks) for the calendar year. Do not include tips received by employees in December of the prior tax year but not reported until January. Include tips received by employees in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**

FORM 8027 RECORD FORMAT			
Field Position	**Field Title**	**Length**	**Description and Remarks**
296–307	Direct Tips Reported	12	**Required.** Enter the total amount of tips reported by directly tipped employees (e.g., servers, bartenders) for the calendar year. Do not include tips received by employees in December of the prior tax year but not reported until January. Include tips received by employees in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
308–319	Total Tips Reported	12	**Required.** Enter the total amount of tips reported by all employees (both indirectly tipped and directly tipped) for the calendar year. Do not include tips received in December of the prior tax year but not reported until January. Include tips received in December of the tax year being reported, but not reported until January of the subsequent year. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
320–331	Gross Receipts	12	**Required.** Enter the total gross receipts from the provision of food and/or beverages for this establishment for the calendar year. Do not include receipts for carry-out sales or sales with an added service charge of 10 percent or more. Do not include in gross receipts charged tips (field positions 248-259) shown on charge receipts unless you have reduced the cash sales amount because you have paid cash to tipped employees for tips they earned that were charged. Do not include state or local taxes in gross receipts. If you do not charge separately for food or beverages along with other services (such as a package deal for food and lodging), make a good faith estimate of the gross receipts attributable to the food or beverages. This estimate must reflect the cost of providing the food or beverages plus a reasonable profit factor. Include the retail value of complimentary food or beverages served to customers if tipping for them is customary and they are provided in connection with an activity engaged in for profit whose receipts would not be included as gross receipts from the provision of food or beverages (e.g., complimentary drinks served to customers at a gambling casino). Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
332–343	Tip Percentage Rate Times Gross Receipts	12	**Required.** Enter the amount determined by multiplying Gross Receipts for the year (field positions 320-331) by the Tip Percentage Rate (field positions 344-347). For example, if the value of Gross Receipts is "000045678900" and Tip Percentage Rate is "0800", multiply $456,789.00 by .0800 to get $36,543.12 and enter "000003654312". If tips are allocated using other than the calendar year, enter zeros; this may occur if you allocated tips based on the time period for which wages were paid or allocated on a quarterly basis. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
344–347	Tip Percentage Rate	4	**Required.** Enter 8 percent (0800) unless a lower rate has been granted by the District Director. The determination letter must accompany the electronic/magnetic submission. **Numeric characters only. Do not enter decimal points, dollars signs, or commas.**

FORM 8027 RECORD FORMAT			
Field Position	**Field Title**	**Length**	**Description and Remarks**
348–359	Allocated Tips	12	**Required.** If Tip Percentage Rate times Gross Receipts (field positions 332-343) is greater than Total Tips Reported (field positions 308-319), then the difference becomes Allocated Tips. Otherwise, enter all zeros. If tips are allocated using other than the calendar year, enter the amount of allocated tips from your records. Amount must be entered in U.S. dollars and cents. The right-most two positions represent cents. Right-justify and zero fill. **If no entry, zero fill. Numeric characters only. Do not enter decimal points, dollars signs, or commas.**
360	Allocation Method	1	**Required.** Enter the allocation method used if Allocated Tips (field positions 348-359) are greater than zero as follows: 0) if allocated tips are equal to zero. 1) for allocation based on hours worked. 2) for allocation based on gross receipts. 3) for allocation based on a good faith agreement. The good faith agreement must accompany the electronic/magnetic submission.
Note: Under Section 1571 of the Tax Reform Act of 1986, the method of allocation of tips based on the number of hours worked as described in Section 31.6053–3(f)(1)(iv) may be utilized only by an employer that employs less than the equivalent of 25 full-time employees at the establishment during the payroll period. Section 31.6053–3(j)(19) provides that an employer is considered to employ less than the equivalent of 25 full-time employees at an establishment during a payroll period if the average number of employee hours worked per business day during the payroll period is less than 200 hours.			
361–364	Number of Directly Tipped Employees	4	**Required.** Enter the total number (must be greater than zero) of directly tipped employees employed by the establishment for the calendar year. Right-justify and zero fill. **Numeric characters only.**
365–369	Transmitter Control Code (TCC)	5	**Required.** Enter the 5-digit Transmitter Control Code assigned by the IRS.
370	Corrected 8027 Indicator	1	**Required.** Enter blank for original return. Enter "G" for corrected return. A corrected return must be a complete new return replacing the original return.
371	*Final Return Indicator*	*1*	**Required.** *Enter "F" if this is the last time you will file Form 8027; otherwise, enter a blank.*
372	*Charge Card Indicator*	*1*	**Required.** *Enter the appropriate code:* *1) if your establishment accepts credit cards, debit cards or other charges.* *2) if your establishment does not accept credit cards, debit cards or other charges.*
373	*ATIP Indicator*	*1*	**Required.** *Enter "T" if you are participating in the Attributed Tip Income Program; otherwise, enter a blank.*
374	*Liable/Not Liable Indicator*	*1*	**Required.** *Enter "N" if you are not liable to file Form 8027 and you are not reporting money amounts; otherwise, enter a blank.*
375–418	*Reserved*	*44*	*Enter blanks.*
419–420	*Blank*	*2*	*Enter blanks.*

FORM 8027 RECORD LAYOUT

Establishment Type	Establishment Serial Numbers	Establishment Name	Establishment Street Address
1	2–6	7–46	47–86

Establishment City	Establishment State	Establishment ZIP Code	Employer Identification Number
87–111	112–113	114–122	123–131

Employer Name	Employer Street Address	Employer City	Employer State
132–171	172–211	212–236	237–238

Employer ZIP Code	Charged Tips	Charged Receipts	Service Charge Less Than 10 Percent
239–247	248–259	260–271	272–283

Indirect Tips Reported	Direct Tips Reported	Total Tips Reported	Gross Receipts
284–295	296–307	308–319	320–331

Tip Percentage Rate Times Gross Receipts	Tip Percentage Rate	Allocated Tips	Allocation Method
332–343	344–347	348–359	360

Number of Directly Tipped Employees	Transmitter Control Code (TCC)	Corrected 8027 Indicator	*Final Return Indicator*
361–364	365–369	370	*371*

Charge Card Indicator	*ATIP Indicator*	*Liable/Not Liable Indicator*	*Reserved*	*Blank*
372	*373*	*374*	*375–418*	*419–420*

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also: Part 1, §§ 83; 1.83–2.)

Rev. Proc. 2006–31

SECTION 1. PURPOSE

This revenue procedure provides guidance concerning the factors that must be present in order for a taxpayer to receive consent to revoke an election previously filed under § 83(b) of the Internal Revenue Code. It also sets out procedures for submitting a request for consent to revoke a valid § 83(b) election.

SECTION 2. BACKGROUND

.01 Under § 83(a), if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, then the excess of the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) as of the first day that the transferee's rights in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over the amount (if any) paid for the property is included in the service provider's gross income for the taxable year which includes that day.

.02 Section 83(b) and §1.83–2(a) of the Income Tax Regulations permit the service provider to elect to include in gross income the excess (if any) of the fair market value of the property at the time of transfer (determined without regard to any lapse restriction, as defined in § 1.83–3(i)) over the amount (if any) paid for the property, as compensation for services. If this election is made, the substantial vesting rules of § 83(a) and the regulations thereunder do not apply to the property, and, assuming there is no compensatory cancellation of a nonlapse restriction, any subsequent appreciation in the value of the property is not taxable as compensation to the service provider.

.03 Under § 83(b)(2), an election made under § 83(b) must be made in accordance with the regulations thereunder and must be filed with the Internal Revenue Service no later than 30 days after the date that the property is transferred to the service provider.

.04 Section 83(b)(2) and § 1.83–2(f) provide that an election under § 83(b) may not be revoked without the consent of the Commissioner. The regulations also provide that such consent will only be granted where the person filing the election is under a mistake of fact as to the underlying transaction and must be requested within 60 days of the date on which the mistake of fact first became known to the person who made the election. Neither a mistake as to the value (or decline in the value) of the property for which the election was made nor the failure of anyone to perform an act that was contemplated at the time of transfer of the property constitute a mistake of fact for this purpose.

.05 The mistake of fact exception in § 1.83–2(f) is narrow in its scope. A mistake of fact is an unconscious ignorance of a fact that is material to the transaction. See 27A AmJur 2d, Equity § 10. By contrast, a mistake of law occurs where a person is ignorant of, or comes to an erroneous conclusion as to, the legal effect of the facts. See 27A AmJur 2d, Equity § 15.

.06 The failure of a service provider to understand the substantial risk of forfeiture associated with the transferred property is not a mistake of fact under § 1.83–2(f).

.07 The failure of a service provider to understand the tax consequences of making an election under § 83(b) is not a mistake of fact under § 1.83–2(f).

.08 The Internal Revenue Service has recognized the principle that an election made under the Code or regulations may be revoked on or before the due date for making the election. See Rev. Rul. 56–67, 1956–1 C.B. 437, dist. by Rev. Rul. 76–393, 1976–2 C.B. 255. See also Rev. Rul. 78–295, 1978–2 C.B. 165. Accordingly, a request for consent to revoke a § 83(b) election will generally be granted if the request is filed on or before the due date for making that § 83(b) election.

.09 If consent to revoke an election under § 83(b) is granted, it will be effective as of the date of the § 83(b) election.

SECTION 3. SCOPE

This revenue procedure applies to taxpayers who wish to revoke a valid election under § 83(b).

SECTION 4. PROCEDURE

.01 A request for consent to revoke an election made under § 83(b) must be made under the procedures for requesting a letter ruling. See Rev. Proc. 2006–1, 2006–1 I.R.B. 1, or its successor.

.02 In addition to a complete description of the facts and the other information and documents required under section 7.01 of Rev. Proc. 2006–1, or its successor, the request must contain: the date the § 83(b) election was made; a copy of the § 83(b) election; a description of the mistake of fact as to the underlying transaction; and the date on which the mistake of fact first became known to the person making the election.

.03 If the request to revoke an election under § 83(b) is being made on or before the due date for making the election, this fact must be included in the request for revocation.

SECTION 5. EXAMPLES

Example 1. On July 10, 2006, in connection with the performance of services, Company M transfers 100 shares of substantially nonvested Company M stock to A, its employee. The restricted stock agreement provides that the stock will revert to Company M if A's employment is terminated for any reason before July 10, 2010. A pays $50X for the shares, which have an aggregate fair market value of $100X on July 10, 2006. On that same day, A files a valid election under § 83(b). On July 28, 2006, A learns that the forfeiture provision in the stock agreement means A will forfeit the stock even if Company M terminates A's employment without cause. In addition, A realizes that A misunderstood the tax results of filing the election. On August 16, 2006, A files a request for a ruling from the Internal Revenue Service for consent to revoke A's § 83(b) election. The request cites A's misunderstanding of the forfeiture provision and A's misunderstanding of the tax results as the basis for the ruling request. While A's request for a ruling is made within 60 days of the date A learns the full meaning of the forfeiture provision and when A realizes the tax results of filing the election, neither reason for which A requests the revocation is a "mistake of fact as to the underlying transaction." The underlying transaction is A's receipt of the restricted stock transferred pursuant to the employment agreement. A's misunderstanding of the forfeiture provision is not a mistake of fact as to the underlying transaction. Rather, it is a failure to understand the substantial risk of forfeiture set forth in the restricted stock agreement. Additionally, A's misunderstanding of the tax results of the election is a mistake of law and not a mistake of fact. Accordingly, consent to revoke the § 83(b) election will not be granted.

Example 2. The facts are the same as in *Example 1*, except that the request for a ruling is filed on August 4, 2006. Because the request is filed within the 30-day period during which the § 83(b) election

could be made, consent to revoke the § 83(b) election will be granted, regardless of the reason for which it is filed.

Example 3. On August 31, 2006, B begins employment with Company O under an employment contract that provides that B will receive Company O Class A common stock. On September 1, 2006, Company O transfers 50X shares of substantially nonvested Company O Class B common stock to B in accordance with the employment contract. B pays $100X for the shares, which have an aggregate fair market value of $100X on that date. On September 15, 2006, B makes a valid election under § 83(b) with respect to the stock transfer. On September 29, 2006, B discovers that Company O has two classes of common stock and that Company O transferred Class B common stock to B instead of Class A common stock. On November 1, 2006, B files a request for a ruling from the Internal Revenue Service to revoke the election. B's request for consent to revoke the § 83(b) election is timely, and it is based on a mistake of fact as to the underlying transaction because B did not receive the property B expected to receive in the transfer. Based on these facts, and absent any other facts to the contrary, consent to revoke the § 83(b) election will be granted because the stock B received was transferred under a mistake of fact as to the underlying transaction.

Example 4. The facts are the same as in *Example 3*, except that B files the request for the ruling on December 15, 2006. Because the request for revocation was not requested within 60 days of the date B discovered the mistake of fact as to the underlying transaction, B's request will not be granted.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective June 13, 2006.

SECTION 7. PAPERWORK REDUCTON ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. § 3507) under control number 1545–2018.

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

The collection of information in this revenue procedure is in section 4. This information is required to evaluate and process the request for consent to revoke the § 83(b) election. The collection of information is required to obtain a letter ruling granting consent to revoke the § 83(b) election. The likely respondents are individuals.

The estimated annual reporting and/or recordkeeping burden is 400 hours.

The estimated annual burden per respondent/recordkeeper varies from 1 to 4 hours.

The estimated number of respondents is 200.

The estimated annual frequency of response is on occasion.

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 return and tax return information are confidential, as required by § 6103.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jean Casey of the Office of Associate Chief Counsel (Tax Exempt & Government Entities). For further information regarding this revenue procedure, contact Jean Casey at (202) 622–6030 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Section 1248 Attribution Principles

REG–135866–02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations under section 1248 of the Internal Revenue Code (Code) that provide guidance for determining the earnings and profits attributable to stock of controlled foreign corporations (or former controlled foreign corporations) that are (were) involved in certain nonrecognition transactions. The proposed regulations are necessary in order to supplement and clarify existing guidance in the regulations under section 1248. The proposed regulations affect persons subject to the regulations under section 1248, as well as persons to which regulations under other Code provisions, such as section 367(b), apply to the extent that those regulations incorporate the principles of the proposed regulations. In addition, the proposed regulations provide that with respect to the sale by a foreign partnership of the stock of a corporation, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporation for purposes of section 1248.

DATES: Written or electronic comments and requests for a public hearing must be received by August 30, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–135866–02), 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–135866–02), 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 *http://www.regulations.gov* (IRS-REG–135866–02).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Michael Gilman at (202) 622–3850 (not a toll-free number); concerning the submissions of comments and request for hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov* (preferred) or at (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 1248(a) of the Code provides that certain gain recognized on the sale or exchange of stock of a foreign corporation by a United States person will be included in the gross income of that person as a dividend if: (1) the foreign corporation was a controlled foreign corporation at any time during the five-year period ending on the date of the sale or exchange; and (2) the United States person owned or is considered to have owned, within the meaning of section 958, 10 percent or more of the total combined voting power of the foreign corporation at any time during that five-year period (section 1248 shareholder). The amount of gain included in income as a dividend under section 1248(a) is limited to the earnings and profits attributable to the stock that is sold or exchanged which were accumulated in taxable years of the foreign corporation beginning after December 31, 1962, and during the period or periods the stock was held by the United States person while the foreign corporation was a controlled foreign corporation. A distribution treated as an exchange of stock is also included. See §1.1248–1(b). In addition, section 1248 may also apply to certain distributions of the stock of a foreign corporation as provided under section 1248(f).

The section 1248 regulations provide for both a simple case method and a complex case method for computing a controlled foreign corporation's earnings and profits attributable to stock disposed of in a transaction to which section 1248 applies. See §§1.1248–2 and 1.1248–3. A taxpayer may use the simple case method under §1.1248–2, which requires few adjustments in the earnings and profits calculation under section 1248, if it meets several criteria (*e.g.*, the foreign corporation has only one class of stock and a constant number of shares outstanding on each day of each post-1962 taxable year which falls within the relevant holding period). If these criteria are not satisfied, a taxpayer must use the complex case method under §1.1248–3. The complex case method provides additional rules to address situations involving multiple classes of stock, changes in a shareholder's ratable share of a corporation's earnings and profits, and other complicating factors.

Under §1.1248–1(a), the period of ownership of stock of a United States person for purposes of attributing earnings and profits to that stock includes the period that the United States person actually held the stock or is considered to have held such stock pursuant to section 1223. Section 1223(1) provides that the period for which the taxpayer has held property received in an exchange, shall include the period for which the taxpayer held the property exchanged if the property received in the exchange has the same basis in whole or in part in the taxpayer's hands as the property exchanged. Section 1223(2) provides that the period for which the taxpayer is considered to have held property acquired shall include the period for which that property was held by any other person if the property acquired has the same basis in whole or in part in the taxpayer's hands as it would have in the hands of that other person.

Section 1248(c)(2) generally provides that, if the United States person selling, exchanging, or distributing stock in a foreign corporation has the required ownership interest in lower-tier foreign corporations, certain earnings and profits of those lower-tier foreign corporations will be attributed to stock of the foreign corporation that the U.S. person sells, exchanges, or distributes. For this provision to apply, the United States person must have owned or be considered to have owned, within the meaning of section 958, 10 percent or more of the total combined voting power of the lower-tier foreign corporation at any time

during the five-year period preceding the sale.

Although section 1248(a) applies only to sales or exchanges of stock in a foreign corporation by a United States person, section 964(e) applies section 1248 principles to certain dispositions of stock in a foreign corporation by a controlled foreign corporation. Section 964(e)(1) provides that if a controlled foreign corporation that owns stock in a foreign corporation sells or exchanges such stock, gain recognized on such sale or exchange shall be included in the gross income of such controlled foreign corporation as a dividend to the same extent that it would have been included under section 1248(a) if the controlled foreign corporation were a United States person.

Section 367(b) addresses certain exchanges described in sections 351, 354, 355, 356, and 361 that do not involve a transfer of property described in section 367(a). One of the underlying policies of section 367(b) is the preservation of the potential application of section 1248. See H.R. Rep. No. 94–658, 94th Cong., 1st Sess., at 242 (November 12, 1975). Regulations under section 367(b) require certain exchanging shareholders to include in income as a deemed dividend the section 1248 amount attributable to stock of a foreign corporation as a result of an acquisition by a foreign corporation of the stock or assets of a foreign corporation in an exchange described in section 351 or a reorganization described in section 368(a)(1). For example, an exchanging shareholder must include the section 1248 amount attributable to the stock exchanged in income if the exchange results in its loss of status as a section 1248 shareholder. See §1.367(b)–4(b)(1). For this purpose, the section 1248 amount generally is determined by reference to the amount that would be included in income as a dividend under section 1248 and the regulations under that section if the stock were sold by the exchanging shareholder. See §1.367(b)–2(c).

Explanation of Provisions

A. *Scope*

The Treasury Department and the IRS believe that it is important that the section 1248 regulations make explicit that only the appropriate amount of earnings and profits are attributed to stock of a foreign corporation for purposes of section 1248 following relevant nonrecognition transactions. The proposed regulations provided in §1.1248–8 supplement and clarify the existing rules under §§1.1248–2 and 1.1248–3. The results obtained under the proposed regulations are consistent with the results provided under section 1248 and the existing regulations under sections 367(b) and 1248. However, some taxpayers have raised concerns that those existing regulations may attribute an excessive amount of earnings and profits to stock after certain nonrecognition transactions. The Treasury Department and the IRS believe that this view is not a correct interpretation of the existing regulations. Nevertheless, in order to remove this uncertainty, the proposed regulations clarify how the principles of section 1248 should be applied so that a section 1248 shareholder or a foreign corporation to which section 964(e) applies includes the appropriate amount in income as a dividend upon the sale or exchange of stock of a current or former controlled foreign corporation.

The proposed regulations provide rules for accurately attributing earnings and profits to stock of a foreign corporation that is received by an exchanging shareholder, or received by an acquiring corporation, pursuant to one or more restructuring transactions in which the holding period of such stock is determined by application of section 1223(1) or 1223(2), and in which the exchanging shareholder is not required, as a result of the exchange, to include in income the section 1248 amount pursuant to §1.367(b)–4(b). The proposed regulations also provide rules for attributing earnings and profits to stock of a foreign corporation that participates in a restructuring transaction that is held by a non-exchanging shareholder in such a restructuring transaction.

For purposes of the proposed regulations, a restructuring transaction is a transaction that qualifies as a nonrecognition transaction (within the meaning of section 7701(a)(45)) under section 351, 354, 356, or 361. The proposed regulations provide special rules for liquidations described in section 332 and consequently, these transactions are not included in the definition of a restructuring transaction. An exchanging shareholder is defined in the proposed regulations as a person that, in a restructuring transaction qualifying for nonrecognition under section 354, 356, or 361(a), exchanges stock of an acquired corporation for stock in either a foreign acquiring corporation or a foreign corporation that is in control of the acquiring corporation. In a restructuring transaction qualifying for nonrecognition under section 351, the proposed regulations define an exchanging shareholder as a person that exchanges property (including stock) for stock in a foreign acquiring corporation. An acquiring corporation is defined in the proposed regulations as a corporation that, in a restructuring transaction, acquires the stock or assets of an acquired corporation. For purposes of the proposed regulations, a foreign corporate shareholder is a foreign corporation that owns stock of another foreign corporation, and has a section 1248 shareholder that is also a section 1248 shareholder of the other foreign corporation. A non-exchanging shareholder is defined in the proposed regulations as a person that, at the time of the restructuring transaction, is either a section 1248 shareholder or a foreign corporate shareholder of the acquiring corporation and that is not an exchanging shareholder with respect to that corporation.

The proposed regulations also set forth rules for the attribution of earnings and profits for purposes of section 1248 with respect to stock of a foreign corporation that receives assets and liabilities of a foreign corporation in a complete liquidation described in section 332 if the foreign distributee is a foreign corporate shareholder of the liquidating corporation. In addition, the proposed regulations provide that with respect to the sale by a foreign partnership of the stock of certain foreign corporations, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporations for purposes of section 1248. Finally, the proposed regulations provide additional rules to ensure the proper attribution of earnings and profits to stock of controlled foreign corporations or foreign corporate shareholders as a result of certain nonrecognition transactions.

B. *Attribution of Earnings and Profits to Stock in a Foreign Corporation as a Result of a Restructuring Transaction*

1. *Earnings and profits attributable to the stock that an exchanging shareholder receives*

Some taxpayers have expressed concern that an excessive amount of earnings and profits could be attributed to stock that an exchanging shareholder receives in a restructuring transaction under the existing section 1248 regulations through the application of the holding period rules of section 1223(1). For example, in a transaction described in section 351, a domestic corporation (DC1) contributes property to a foreign acquiring corporation (FA) in exchange for 80 percent of the voting stock in FA. Prior to the transaction, FA was wholly owned by another domestic corporation (DC2). Assume in the transaction that DC1 does not recognize gain under section 367(a) and the regulations under that section or include income under section 367(b) and the regulations under that section. The basis of the stock in FA received by DC1 in the transaction will be determined pursuant to section 358, and in determining DC1's holding period in the FA stock, DC1 will include, under section 1223(1), the period DC1 held the property it contributed to FA. Some taxpayers incorrectly interpret the existing section 1248 regulations to require that, if DC1 subsequently sells or exchanges the FA stock received in the restructuring transaction, the earnings and profits accumulated by FA before the transaction (*i.e.*, before DC1's period of actual ownership of the FA stock), but within the section 1223(1) holding period, are attributed to the FA stock received and sold by DC1. This interpretation would result in the inappropriate attribution of such accumulated earnings and profits to the FA stock held by both DC2 and DC1 (if DC2 sells or exchanges its FA stock, the accumulated earnings and profits of FA that were attributed to the FA stock sold by DC1 would correctly be attributed under the existing section 1248 regulations to the FA stock held by DC2).

This interpretation of the existing section 1248 regulations is not correct and any such double attribution is not intended. However, to provide greater certainty, the proposed regulations clarify that excessive attribution of earnings and profits does not occur as a result of restructuring transactions. The proposed regulations provide that where an exchanging shareholder receives, in a restructuring transaction, stock in a foreign corporation, the holding period of which is determined under section 1223(1), and the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign corporation immediately after the restructuring transaction, the earnings and profits attributable to the stock the exchanging shareholder receives shall be determined on the basis of the type of property exchanged.

If the property exchanged is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder immediately before the transaction, the earnings and profits attributable to the foreign corporation stock received by the exchanging shareholder shall be determined in accordance with §1.1248–2 or §1.1248–3 (whichever is applicable) without regard to any portion of the section 1223(1) holding period in that stock that reflects periods prior to the restructuring transaction.

If, on the other hand, the property exchanged is stock in a foreign acquired corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder with respect to the foreign corporation immediately before the transaction, the proposed regulations provide that the earnings and profits attributable to the stock received by the exchanging shareholder shall equal the sum of the earnings and profits attributable to: (1) the stock of the foreign acquired corporation accumulated prior to the restructuring transaction; and (2) the stock of the foreign corporation that the exchanging shareholder receives in the restructuring transaction without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. The earnings and profits attributable to any portion of the section 1223(1) holding period in the foreign acquiring stock that is prior to the restructuring transaction remain attributable through the operation of the existing section 1248 regulations to the foreign acquiring stock held by non-exchanging shareholders. See proposed §1.1248–8(b)(4) and (7), *Example 2*.

The proposed regulations provide an exception to this general rule, however, in certain triangular reorganizations involving a foreign issuing corporation that controls a domestic acquiring corporation. This exception applies, for example, where a United States person (DC) exchanges its stock in a foreign acquired corporation (FS) for stock of a foreign issuing corporation (FI) that controls the domestic acquiring corporation (DA) in a restructuring transaction (*i.e.*, a triangular reorganization described in section 368(a)(1)(B)). To prevent the attribution of FS's pre-acquisition earnings and profits to stock owned by both DC and DA, the proposed regulations provide that the earnings and profits attributable to the FI stock received by DC shall consist solely of the earnings and profits attributable to the FI stock received (determined under §1.1248–2 or §1.1248–3, whichever is applicable, and proposed §1.1248–8, if applicable) without regard to any portion of DC's section 1223(1) holding period in the FI stock received that includes periods of time prior to the restructuring transaction. See proposed §1.1248–8(b)(7), *Example 5*. As discussed in paragraph (B)(2) of this preamble, the earnings and profits attributable to the FS stock for periods before the triangular reorganization generally are attributed to the FS stock owned by DA after the transaction.

2. *Earnings and profits attributable to stock in a foreign corporation that certain acquiring corporations receive*

In addition to potential excessive attribution resulting from section 1223(1) holding periods discussed above, some taxpayers are concerned that an excessive amount of earnings and profits could be attributed to stock under the existing section 1248 regulations through the application of the section 1223(2) holding period rules to an acquiring corporation in a restructuring transaction. For example, in a transaction described in section 351, a foreign corporation (FP) that owns 100 percent of the stock of another foreign corporation (FS) and 100 percent of the stock of a domestic corporation (DC), transfers its FS stock to DC. Prior to the transaction, FP was not a section 1248 shareholder or a

foreign corporate shareholder with respect to FS. DC's basis in the FS stock received by DC in the restructuring transaction will be determined pursuant to section 362, and in determining DC's holding period in the FS stock, DC will include, under section 1223(2), the period FP held the FS stock. Some taxpayers incorrectly interpret the existing section 1248 regulations to require that if DC subsequently sells or exchanges the FS stock received in the restructuring transaction, the earnings and profits accumulated by FS before the transaction (*i.e.*, before DC's period of actual ownership of the FS stock), but within the 1223(2) holding period, are attributed to the FS stock received and sold by DC. This interpretation would result in the attribution of earnings and profits to the FS stock held by DC even though such earnings and profits were accumulated by FS when it was not a controlled foreign corporation.

Such interpretation of the existing section 1248 regulations is not correct. However, to provide greater certainty, the proposed regulations clarify that excessive attribution of earnings and profits does not occur as a result of such transactions. The proposed regulations provide that where, in a restructuring transaction, an acquiring corporation receives stock in a foreign acquired corporation, the holding period of which is determined under section 1223(2), and the acquiring corporation is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign acquired corporation immediately after the restructuring transaction, the earnings and profits attributable to the foreign acquired corporation stock that the acquiring corporation receives shall be determined depending on whether the exchanging shareholder was a section 1248 shareholder or a foreign corporate shareholder with respect to the acquired corporation. If the exchanging shareholder is neither a section 1248 shareholder nor a foreign corporate shareholder with respect to the foreign acquired corporation immediately before the restructuring transaction, the proposed regulations provide that the earnings and profits attributable to the stock of the foreign acquired corporation shall be determined in accordance with §1.1248–2 or §1.1248–3 (whichever is applicable) without regard to any portion of the section 1223(2) holding period in that stock that is prior to the restructuring transaction.

However, in a restructuring transaction where the acquiring corporation receives stock of a foreign acquired corporation with respect to which an exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder immediately before the transaction, the proposed regulations modify the approach discussed above in order to ensure the proper amount of earnings and profits is attributable to stock that the acquiring corporation receives. For example, assume a domestic corporation (DC1) has owned all the stock of a foreign corporation (FS) since its formation. In a transaction described in section 368(a)(1)(B), DC1 transfers all its FS stock to another domestic corporation (DC2), in exchange for DC2 voting stock. The section 1248 amount attributable to the FS stock is $100 but section 367(b) does not require DC1 to include it in income as a deemed dividend. See §1.367(b)–4(a) (income inclusion rules only apply when there is a foreign acquiring corporation). If DC2 subsequently recognizes gain upon the sale or exchange of its stock in FS and if the earnings and profits attributable to that stock do not include the earnings and profits that accumulated before DC2's actual period of ownership, then those earnings and profits would escape inclusion in income as a dividend under section 1248.

To ensure the proper attribution of earnings and profits in these situations, the proposed regulations provide that where the stock exchanged in the restructuring transaction is stock of a foreign corporation, with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder immediately before the restructuring transaction, the earnings and profits attributable to the stock of the acquired corporation will be determined with regard to the portion of the section 1223(2) holding period in that stock that the exchanging shareholder took into account for purposes of attributing earnings and profits to that stock. See proposed §1.1248–8(b)(7), *Example 3* and *Example 5*.

3. *Earnings and profits attributable to stock held by a non-exchanging shareholder*

The proposed regulations generally provide that the earnings and profits attributable to stock of an acquiring corporation held by a non-exchanging shareholder immediately prior to a restructuring transaction continue to be attributed to such stock, and the earnings and profits of the acquired corporation accumulated prior to the restructuring transaction attributable to the stock of an acquired corporation are not attributed to the non-exchanging shareholder's stock in the acquiring corporation. See proposed §1.1248–8(b)(7), *Example 2* and *Example 4*.

However, a special rule applies to a nonexchanging shareholder that owns stock in a foreign corporation that is both an acquiring corporation and an exchanging shareholder in the same restructuring transaction (*i.e.*, an upstream merger). This rule is necessary because the acquiring corporation does not receive stock in exchange for its stock in the acquired corporation and, as a result, the general attribution rules in the proposed regulations would not preserve the earnings and profits attributable to such acquired corporation stock. For example, assume a domestic corporation (DC) owns all the stock of a controlled foreign corporation (CFC1), CFC1's only asset is 79 percent of the stock of another controlled foreign corporation (CFC2), and the other 21 percent of the CFC2 stock is owned by an unrelated party (X). Pursuant to a restructuring transaction described in section 368(a)(1)(C), CFC2 transfers all its assets to CFC1. In exchange, CFC1 assumes the liabilities of CFC2 and transfers to CFC2 voting stock representing 21 percent of the stock of CFC1. CFC2 distributes the voting stock to X and liquidates. In such a transaction, the earnings and profits attributable to the CFC1 stock held by DC (*i.e.*, the nonexchanging shareholder) shall be the sum of the earnings and profits attributable to the stock of CFC1 (*i.e.*, the foreign acquiring corporation) immediately before the restructuring transaction (including amounts attributed under section 1248(c)(2)) and the earnings and profits attributable to the stock of CFC1 accumulated after the restructuring transaction (including amounts attributed under section 1248(c)(2)). See

proposed §1.1248–8(b)(7), *Example 8*. Cf. proposed §1.1248–8(c) (providing similar rules for liquidations described in section 332).

4. *Reduction in earnings and profits attributable to stock to prevent multiple inclusions with respect to the same earnings and profits*

The proposed regulations require that, to the extent consistent with the principles of section 1248, adjustments to earnings and profits attributable to stock shall be made so that section 1223(1) and (2) and the proposed regulations are applied in a manner that results in earnings and profits being taken into account only once. Accordingly, the proposed regulations provide that upon the sale by a controlled foreign corporation of stock of another foreign corporation to which earnings and profits had been attributed under the rules of the proposed regulations, proportionate reductions shall be made to the earnings and profits attributed to the stock of the selling foreign corporate shareholder owned by a section 1248 shareholder. See proposed §1.1248–8(b)(7), *Example 7*. For example, assume a section 1248 shareholder owns 80 percent of a controlled foreign corporation (CFC1) and an unrelated foreign person owns the remaining 20 percent of CFC1. The section 1248 shareholder receives the CFC1 stock in exchange for the stock of its wholly owned foreign subsidiary (CFC2) in a restructuring transaction described in section 368(a)(1)(B). Immediately before the transaction, $100 of earnings and profits is attributable to the CFC2 stock owned by the section 1248 shareholder. As previously discussed, the proposed regulations provide for the attribution of the $100 of CFC2's pre-acquisition earnings and profits to the CFC1 stock received by the section 1248 shareholder in the transaction and to the CFC2 stock received by CFC1 in the transaction. Assume that CFC2 accumulates another $100 of earnings and profits after the transaction, and in a subsequent year, CFC1 sells 30 percent of its stock in CFC2. If the requirements of section 964(e) are met, CFC1 will include in its gross income as a dividend $30 of CFC2's pre-acquisition earnings and profits and $30 of CFC2's post-acquisition earnings and profits. In order to prevent the attribution of a portion of these earnings and profits to the section 1248 shareholder's stock in CFC1, the proposed regulations provide that the earnings and profits attributable to the section 1248 shareholder's stock in CFC1 will be reduced by $54, $24 (80 percent of $30) of the earnings and profits accumulated by CFC2 after the restructuring transaction and $30 of the earnings and profits accumulated by CFC2 prior to the restructuring transaction.

5. *Special rule regarding section 381*

The proposed regulations also provide a special rule in order to avoid possible double counting of earnings and profits as a result of the operation of section 381(a) in a restructuring transaction and the proposed rules. Under section 381, an acquiring corporation succeeds to and takes into account the earnings and profits of the transferor or distributor corporation as of the close of the day of the transfer or distribution. Because the earnings and profits carry over from one corporation to another corporation at the close of the day, the same earnings and profits accumulated by the transferor or distributor corporation before the transaction could also be considered to have been accumulated by the transferee or distributee corporation after the transfer or distribution. For example, assume a domestic corporation (DC1) owns 100 percent of controlled foreign corporation (CFC1) that generates $100 of earnings and profits. CFC1 merges into another controlled foreign corporation (CFC2) in a reorganization described in section 368(a)(1)(A), and DC1 receives 25 percent of the CFC2 stock in exchange for its CFC1 stock in the merger. If, for purposes of section 1248, the $100 of earnings and profits of CFC1 is attributable to the CFC2 stock received by DC1, and is also taken into account by CFC2 pursuant to section 381, the same $100 of earnings and profits would be taken into account twice.

Except with respect to upstream mergers, the proposed regulations attribute the pre-acquisition earnings and profits of the transferor, where appropriate, to the stock received by the exchanging shareholder. Therefore, in order to prevent the double counting of earnings and profits, the proposed regulations provide that earnings and profits of another corporation to which the foreign corporation succeeded through the operation of section 381 will not be attributed to its stock. See proposed §1.1248–8(b)(6) and (7), *Example 4*, and (c)(2) and (3).

6. *Attribution of earnings and profits following certain liquidations*

Under the existing section 1248 regulations, issues have arisen as to whether the so-called hovering deficit rule under section 381(c)(2)(B) applies for purposes of attributing earnings and profits to stock of the foreign distributee corporation following certain liquidations of foreign corporations under section 332. The hovering deficit rule generally restricts access to certain deficits in earnings and profits following section 381 transactions. The Treasury Department and the IRS believe that the hovering deficit rule should not apply in these types of section 332 liquidations because section 1248(c)(2) generally provides for the attribution of a foreign subsidiary's earnings and profits (including any deficits) to the stock of its foreign parent. Thus, the foreign parent already had, in effect, access to the deficit of the foreign subsidiary pursuant to section 1248(c)(2) prior to the section 332 liquidation. In that case, application of the hovering deficit rule is not appropriate for section 1248 purposes.

Accordingly, the proposed regulations provide a special rule that clarifies application of the hovering deficit rule to a distributee foreign corporate shareholder in a section 332 liquidation. In this circumstance, the earnings and profits of the distributing foreign corporation to which the foreign distributee corporation succeeds through the operation of section 381 will not be taken into account by the foreign distributee for purposes of section 1248 and consequently, the hovering deficit rule will not apply. Instead, the proposed regulations provide a rule for attributing earnings and profits of the foreign liquidating corporation to the stock of the foreign distributee in such a liquidation that is consistent with the principles of section 1248(c)(2). In such a case, the earnings and profits attributable to the distributee stock shall be the sum of: (1) the earnings and profits attributable to the stock of the distributee immediately before the liquidation (including amounts

attributed under section 1248(c)(2)); and (2) the earnings and profits attributable to the stock of the distributee accumulated after the liquidation (including amounts attributed under section 1248(c)(2)). See proposed §1.1248–8(b)(7), *Example 3*, and (c).

C. *Sale or Exchange of Stock by a Foreign Partnership*

A domestic partnership is treated as a United States person for purposes of section 1248. See section 7701(a)(30)(B) and §1.1248–1(a)(1). Accordingly, the sale by a domestic partnership of the stock of a foreign corporation is subject to section 1248(a). Section 1248 and the existing regulations do not, however, address specifically sales or exchanges of stock by foreign partnerships with United States persons as partners.

The legislative history of subchapter K of the Code provides that, for purposes of interpreting Code provisions outside of that subchapter, a partnership may be treated as either an entity separate from its partners or an aggregate of its partners, depending on which characterization is more appropriate to carry out the purpose of the particular Code section under consideration. H.R. Conf. Rep. No. 2543, 83rd Cong. 2d. Sess. 59 (1954). The purpose of section 1248 is to ensure that earnings and profits of controlled foreign corporations (or former controlled foreign corporations) are taxed as a dividend when certain United States persons recognize gain on the sale or exchange of stock in such corporations. In cases in which the United States person is a partner in a foreign partnership and recognizes income on the sale of stock of a foreign corporation by such foreign partnership, the purpose of section 1248 is fulfilled only if the partnership is treated as an aggregate for section 1248 purposes. Treatment of a foreign partnership as an entity, in contrast, could result in partners in the partnership inappropriately receiving capital gain treatment on the sale by the partnership of stock of the foreign corporation.

Thus, under proposed §1.1248–1(a)(4), a foreign partnership is treated as an aggregate of its partners for purposes of section 1248(a). Under the proposed regulations, for example, the partners in a foreign partnership shall be treated as selling or exchanging their proportionate share of stock held by the foreign partnership. The proposed regulations also apply section 1248(a) in cases where the stock in a corporation that is sold or exchanged is held through tiers of foreign partnerships. This treatment of the foreign partnership as an aggregate, rather than as an entity, for purposes of applying section 1248 is necessary to reflect properly the attributable earnings and profits as a dividend.

D. *Removal of Rule under §1.367(b)–2(d)(3)(ii) Limiting Amounts Attributable to Holding Periods Determined under Section 1223*

Section 1.367(b)–3 requires that an exchanging shareholder, as defined in §1.367(b)–3(b)(1), include the all earnings and profits amount (as defined generally in §1.367(b)–2(d)) in income as a deemed dividend (with respect to its stock in the foreign acquired corporation) when a domestic corporation acquires the assets of the foreign corporation in a section 332 liquidation or a section 368(a)(1) asset acquisition. Section 1.367(b)–2(d)(3)(ii) excludes, for purposes of determining the all earnings and profits amount, amounts attributable to holding periods determined under section 1223(2) during which there was no direct or indirect ownership by a United States person. Pursuant to §1.367(b)–2(d)(3)(i)(A)(*1*), the all earnings and profits amount with respect to stock of a foreign corporation is determined according to the attribution principles of section 1248 and the regulations under that section. Since the rules of proposed §1.1248–8(b)(2) conform to the rule set forth in §1.367(b)–2(d)(3)(ii), the proposed regulations remove paragraph (d)(3)(ii) from §1.367(b)–2.

E. *Revision of §1.367(b)–4(d) Providing Rules for Subsequent Exchanges*

Section 1.367(b)–4 applies to an acquisition by a foreign corporation of the stock or assets of a foreign corporation in an exchange described in section 351 or a reorganization described in section 368(a)(1). If the exchange meets certain criteria, an exchanging shareholder, as defined in §1.367(b)–4(b)(1)(i)(A), must include in income as a deemed dividend the section 1248 amount attributable to the stock that it exchanges. If in a particular exchange, income is not required to be included pursuant to §1.367(b)–4(b), §1.367(b)–4(d) provides rules governing the attribution of earnings and profits to the stock received by the exchanging shareholder in the non-inclusion exchange for purposes of applying section 367(b) or section 1248 to subsequent sales or exchanges of that stock.

Because proposed §1.1248–8 provides rules for the attribution of earnings and profits to stock with respect to the §1.367(b)–4(b) non-inclusion exchanges, the proposed regulations remove the substantive rules and examples in §1.367(b)–4(d) from the final regulations. In their place, taxpayers are referred to proposed §1.1248–8.

F. *Request for Comments*

1. *Attribution to stock shareholder receives by gift*

The proposed regulations do not apply to determine the earnings and profits attributable to stock in a foreign corporation that a United States person receives as a gift. The Treasury Department and the IRS seek comments as to whether additional guidance is needed to address the attribution of earnings and profits with respect to stock of a foreign corporation that a United States person receives by gift.

2. *Attribution of earnings and profits to stock shareholder receives under section 355*

The proposed regulations do not apply to determine the earnings and profits attributable to stock in a foreign corporation that a United States person receives in a distribution to which section 355 applies. The Treasury Department and the IRS seek comments as to whether additional guidance is needed to address the attribution of earnings and profits with respect to stock of a foreign corporation that a United States person receives in such distributions.

3. *Effect on §§1.1248–4 and 1.1248–5*

The proposed regulations do not address the interaction of proposed §1.1248–8 with §§1.1248–4 and 1.1248–5. The Treasury Department

and the IRS seek comments as to whether additional guidance on how the proposed regulations should affect those sections of the existing regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of 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 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 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 Treasury Department and the IRS 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 submits timely written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of the proposed regulations are Michael I. Gilman of the Office of Associate Chief Counsel (International) and Mark R. Pollard, formerly of the Office of Associate Chief Counsel (International). However, other personnel from the Treasury Department and the IRS 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 is amended by adding entries in numerical order to read in part as follows:

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

Sections 1.367(b)–2(c)(1) and (2) and (d)(3), and 1.367(b)–4(d) also issued under 26 U.S.C. 367(b)(1) and (2).* * *

Sections 1.1248–1(a)(1), (4), and (5), and 1.1248–8 also issued under 26 U.S.C. 1248(a) and (c)(1) and (2).* * *

§1.367(b)–2 [Amended]

Par. 2. Section 1.367(b)–2 is amended by:

1. Amending the last sentence of paragraph (c)(1)(ii) by removing the language ", as modified by §1.367(b)–4(d) (as applicable)" and adding the language ". See §1.1248–8." in its place.

2. Removing *Example 4* in paragraph (c)(2).

3. Amending the last sentence of paragraph (d)(3)(i)(B)(*2*) by removing the language ", as modified by paragraph (d)(3)(ii) of this section and §1.367(b)–4(d) (as applicable)" and adding the language ". See §1.1248–8." in its place.

4. Removing paragraph (d)(3)(ii).

5. Redesignating paragraph (d)(3)(iii) as paragraph (d)(3)(ii).

Par. 3. Section 1.367(b)–4(d) is revised to read as follows:

§1.367(b)–4 Acquisition of foreign corporate stock or assets by a foreign corporation in certain nonrecognition transactions.

* * * * *

(d) *Rules for subsequent sales or exchanges*. If an exchanging shareholder (as defined in §1.1248–8(b)(1)(iv)) is not required to include in income as a deemed dividend the section 1248 amount under paragraph (b) of this section in a section 367(b) exchange described in paragraph (a) of this section (non-inclusion exchange), then, for purposes of applying section 367(b) or section 1248 to subsequent sales or exchanges, and subject to the limitation of §1.367(b)–2(d)(3)(ii) (in the case of a transaction described in §1.367(b)–3), the determination of the earnings and profits attributable to the stock an exchanging shareholder receives in the non-inclusion exchange shall be determined pursuant to the rules of section 1248 and the regulations under that section.

Par. 4. Section 1.1248–1 is amended by:

1. Amending the first sentence of paragraph (a)(1) by removing the language "(or was considered as held by reason of the application of section 1223)" and adding the language "(or was considered as held by reason of the application of section 1223, taking into account §1.1248–8)" in its place.

2. Adding a new third sentence in paragraph (a)(1).

3. Redesignating paragraph (a)(4) as paragraph (a)(5).

4. Adding new paragraph (a)(4).

5. Adding *Example 4* in newly designated paragraph (a)(5).

The additions read as follows:

§1.1248–1 Treatment of gain from certain sales or exchanges of stock in certain foreign corporations.

(a) *In general*. (1) * * * See §1.1248–8 for additional rules regarding the attribution of earnings and profits to the stock of a foreign corporation following certain nonrecognition transactions. * * *

* * * * *

(4) For purposes of paragraph (a)(1) of this section, stock of a corporation that is owned by a foreign partnership shall be considered as owned proportionately by its partners. Consequently, if a foreign partnership sells or exchanges stock of a corporation, the partners in such foreign partnership shall be treated as selling or exchanging their proportionate share of the stock of such corporation. Stock considered to be owned by a partner by reason of the application of the first sentence of this paragraph (a)(4) shall, for purposes of applying such sentence, be treated as actually owned by such partner.

(5) * * *

Example 4. (i) *Facts.* X, a domestic corporation, and Y, a foreign corporation that is not a controlled foreign corporation, are partners in foreign partnership Z. X has a 60% interest in Z, and Y has a 40% interest in Z. All parties are calendar year taxpayers. On January 1, year 1, Z forms foreign corporation H, a controlled foreign corporation that conducts a business in Country C. On December 31, year 2, Z sells all of the H stock for $600 when Z's adjusted basis in the stock is $100. Therefore, Z recognizes a gain of $500 on the sale, of which $300 is allocable to X as a 60% partner. At the time of the sale, H had $300 of earnings and profits, $180 of which (*i.e.*, 60% of $300) is attributable to X's 60% share of the H stock.

(ii) *Analysis.* Pursuant to section 1248(a) and paragraphs (a)(1) and (4) of this section, X and Y are treated as selling 60% and 40%, respectively, of the H stock. X includes in its gross income as a dividend $180 of the gain recognized on the sale. Because Y is a foreign corporation that is not a CFC, neither section 1248 nor section 964 applies to the sale of Y's 40% share of the H stock.

(iii) *Alternative facts.* If, instead, X owned its 60% interest in Z through another foreign partnership, the result would be the same.

* * * * *

§§1.1248–2, 1.1248–3, 1.1248–7 [Amended]

Par. 5. In §§1.1248–2, 1.1248–3, and 1.1248–7, for each entry in the "Section" column, remove the language in the "Remove" column and add the language in the "Add" column in its place.

Section	Remove	Add
§1.1248–2(a)(1)	(or was considered to be held by reason of the application of section 1223)	(or was considered to be held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(a)(2)(ii)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(a)(3)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(c)(4)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(1), introductory text	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(2)	(or is considered as held by reason of the application of section 1223)	(or is considered as held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–2(e)(3)(i)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(a)(1)	(or was considered to be held by reason of the application of section 1223)	(or was considered to be held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(c)(1)(ii)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(e)(2)(i)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(e)(3)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223)	(during the period such share, or block, was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)

Section	Remove	Add
§1.1248–3(e)(5)	(or another person who actually owned the stock during such taxable year and whose holding of the stock is attributed by reason of the application of section 1223 to the person who sold or exchanged the stock)	(or another person who actually owned the stock during such taxable year and whose holding of the stock is attributed by reason of the application of section 1223, taking into account §1.1248–8, to the person who sold or exchanged the stock)
§1.1248–3(e)(6), in both locations	by reason of the application of section 1223 to such person	by reason of the application of section 1223 to such person, taking into account §1.1248–8
§1.1248–3(f)(2)(ii)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(f)(5)(ii)	(during the period such stock was considered to be held by such person by reason of the application of section 1223)	(during the period such stock was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–3(f)(5)(iv)	(during the period such share (or block) was considered to be held by such person by reason of the application of section 1223)	(during the period such share (or block) was considered to be held by such person by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(3)(i)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(3)(iii)	(or is considered to have held by reason of the application of section 1223)	(or is considered to have held by reason of the application of section 1223, taking into account §1.1248–8)
§1.1248–7(b)(4)	(or was considered to have held by reason of the application of section 1223)	(or was considered to have held by reason of the application of section 1223, taking into account §1.1248–8)

Par. 6. Section 1.1248–8 is added to read as follows:

§1.1248–8 Earnings and profits attributable to stock following certain non-recognition transactions.

(a) *Scope*. This section sets forth rules for the attribution of earnings and profits for purposes of section 1248 and §1.1248–1(a)(1) and to supplement the rules in §§1.1248–2 and 1.1248–3 with respect to—

(1) *Stock that an exchanging shareholder receives, or an acquiring corporation receives, in restructuring transactions*. Except as otherwise provided in this paragraph (a), stock of a foreign corporation that an exchanging shareholder receives, or an acquiring corporation receives, pursuant to a restructuring transaction (as defined in paragraph (b)(1)(vii) of this section) in which the holding period of such stock is determined by application of section 1223(1) or 1223(2), whichever is appropriate. This section shall not apply to an exchange otherwise described in this paragraph (a)(1) if, as a result of the exchange, the exchanging shareholder is required to include in income as a deemed dividend the section 1248 amount pursuant to §1.367(b)–4(b). See paragraphs (b)(2) and (3) of this section;

(2) *Nonexchanging shareholders*. Stock of a foreign corporation that participates in a restructuring transaction that is held by a non-exchanging shareholder (as defined in paragraph (b)(1)(vi) of this section) in the restructuring transaction. See paragraph (b)(4) of this section;

(3) *Application of section 381*. Stock of a foreign corporation that receives assets in a transfer to which section 361(a) applies in connection with a reorganization described in section 368(a)(1)(A), (C), (D), (F), or (G), or in a distribution to which section 332 applies, and to which section 381(c)(2)(A) and §1.381(c)(2)–1(a) apply. See paragraph (b)(6) of this section; or

(4) *Section 332 liquidations*. Stock of a foreign corporation that receives the assets and liabilities of a foreign corporation in a complete liquidation described in section 332 if the foreign distributee is a foreign corporate shareholder (as defined in paragraph (b)(1)(v) of this section) of the liquidating corporation. See paragraph (c) of this section.

(b) *Earnings and profits attributable to stock following a restructuring transaction*—(1) *Definitions*. The following definitions apply for purposes of this section—

(i) *Acquired corporation* is a corporation whose stock or assets are acquired in exchange for stock in (or stock in and other property of) either the acquiring cor-

poration or a foreign corporation that controls, within the meaning of section 368(c), the acquiring corporation in a restructuring transaction.

(ii) *Acquiring corporation* is a corporation that acquires the stock or assets of an acquired corporation in a restructuring transaction.

(iii) *Controlled foreign corporation* is a corporation described in section 957.

(iv) *Exchanging shareholder* is a person that exchanges—

(A) In a restructuring transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 354, 356, or 361(a), stock in an acquired corporation for stock in either a foreign acquiring corporation or a foreign corporation that is in control, within the meaning of section 368(c), of an acquiring corporation (whether domestic or foreign); or

(B) In a restructuring transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 351, property (including stock) for stock in a foreign acquiring corporation.

(v) *Foreign corporate shareholder* is a foreign corporation that—

(A) Owns stock of another foreign corporation; and

(B) Has a section 1248 shareholder that is also a section 1248 shareholder of the other foreign corporation.

(vi) *Non-exchanging shareholder* is, at the time the acquiring corporation participates in a restructuring transaction, either a section 1248 shareholder or a foreign corporate shareholder of the acquiring corporation that is not an exchanging shareholder with respect to that corporation.

(vii) *Restructuring transaction* is a transaction qualifying as a nonrecognition transaction within the meaning of section 7701(a)(45) and described in section 351, 354, 356, or 361.

(viii) *Section 1248 shareholder* is any United States person that satisfies the ownership requirements of section 1248(a)(2) and §1.1248–1(a)(2) with respect to a foreign corporation.

(2) *Earnings and profits attributable to stock that an exchanging shareholder receives in a restructuring transaction*. Where, in a restructuring transaction, an exchanging shareholder receives stock in a foreign corporation, the holding period of which is determined under section 1223(1), and the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign corporation immediately after the restructuring transaction, the earnings and profits attributable to the stock the exchanging shareholder receives shall be determined pursuant to the rules in paragraphs (b)(2)(i), (ii) and (iii) of this section.

(i) *Exchanging shareholder exchanges property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder*. Where the exchanging shareholder exchanges in a restructuring transaction property that is not stock of a foreign acquired corporation with respect to which the exchanging shareholder is a section 1248 shareholder or a foreign corporate shareholder immediately before such transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7), *Example 1* of this section.

(ii) *Exchanging shareholder exchanges stock of a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder*. Except as provided in paragraph (b)(2)(iii) of this section, where the exchanging shareholder exchanges in a restructuring transaction stock of a foreign acquired corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder immediately before such restructuring transaction, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall be the sum of the earnings and profits attributable to—

(A) The stock of the foreign acquired corporation exchanged (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable) that was accumulated before the restructuring transaction; and

(B) The stock of the foreign corporation that the exchanging shareholder receives in the restructuring transaction (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable), without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7), *Example 2*, *Example 4*, and *Example 6* of this section.

(iii) *Exchanging shareholder receives stock in a foreign corporation that controls a domestic acquiring corporation*. Where the acquiring corporation is a domestic corporation and the exchanging shareholder receives in a restructuring transaction stock in a foreign corporation that controls (within the meaning of section 368(c)) the domestic acquiring corporation, the earnings and profits attributable to the stock that the exchanging shareholder receives in the restructuring transaction shall consist solely of the amount of earnings and profits attributable to such stock (determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, and this section, if applicable) without regard to any portion of the section 1223(1) holding period in that stock that is prior to the restructuring transaction. See paragraph (b)(7), *Example 5* of this section.

(3) *Earnings and profits attributable to stock in a foreign corporation certain acquiring corporations receive in a restructuring transaction*. Where an acquiring corporation receives, in a restructuring transaction, stock in a foreign acquired corporation, the holding period of which is determined under section 1223(2), and the acquiring corporation is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign acquired corporation immediately after the restructuring transaction, the earnings and profits attributable to the foreign acquired corporation stock that the acquiring corporation receives shall be determined pursuant to the rules in paragraphs (b)(3)(i) and (ii) of this section.

(i) *Stock of a foreign corporation with respect to which the exchanging shareholder is neither a section 1248 shareholder nor a foreign corporate shareholder*. The earnings and profits attributable to the stock of the foreign acquired corporation that the acquiring corpora-

tion receives in a restructuring transaction where the exchanging shareholder is neither a section 1248 shareholder nor a foreign corporate shareholder with respect to that foreign acquired corporation immediately before the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, without regard to any portion of the section 1223(2) holding period in that stock that is prior to the restructuring transaction.

(ii) *Stock of a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder.* The earnings and profits attributable to the stock of a foreign acquired corporation that the acquiring corporation receives in the restructuring transaction where the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder with respect to that foreign corporation immediately before the restructuring transaction shall be determined in accordance with §1.1248–2 or §1.1248–3, whichever is applicable, with regard to the portion of the section 1223(2) holding period of the stock that the exchanging shareholder took into account for purposes of attributing earnings and profits to that stock (determined in accordance with this section). See paragraph (b)(7), *Example 3*, *Example 5*, and *Example 7* of this section.

(4) *Earnings and profits attributable to stock held by a non-exchanging shareholder in a foreign acquiring corporation.* (i) Except to the extent paragraph (b)(4)(ii) of this section applies, see §1.1248–2 or §1.1248–3 (whichever is applicable) and, as applicable, paragraph (b)(6) of this section for the determination of the earnings and profits attributable to the stock held by a non-exchanging shareholder in a foreign acquiring corporation. See also paragraph (b)(7), *Example 2* and *Example 4* of this section.

(ii) Where a non-exchanging shareholder holds stock in a foreign corporation that is also an exchanging shareholder and a foreign acquiring corporation in the same restructuring transaction—

(A) The earnings and profits attributable to such stock shall be the sum of the earnings and profits attributable to the stock of such foreign corporation immediately before the restructuring transaction (including amounts attributed under section 1248(c)(2)) and the earnings and profits attributable to the stock of the foreign acquiring corporation accumulated after the restructuring transaction (including amounts attributed under section 1248(c)(2)); and

(B) Paragraph (b)(6) of this section applies. See paragraph (b)(7), *Example 8* of this section.

(iii) Where the acquiring corporation is a foreign corporate shareholder with respect to stock of a foreign acquired corporation, paragraph (b)(3) of this section shall not apply for purposes of determining the earnings and profits attributable to stock in the foreign acquiring corporation owned by a non-exchanging shareholder thereof (see section 1248(c)(2)). See paragraph (b)(7), *Example 6* of this section.

(5) *Reduction in earnings and profits attributable to stock to prevent multiple inclusions with respect to the same earnings and profits.* To the extent consistent with the principles of section 1248, adjustments to earnings and profits attributable to stock shall be made such that section 1223(1) and (2) and this section are applied in a manner that results in earnings and profits being taken into account only once. Thus, for example, when a controlled foreign corporation sells or exchanges all or part of the stock of another foreign corporation to which earnings and profits are attributable pursuant to this paragraph (b) or paragraph (c) of this section, proportionate reductions shall be made to the earnings and profits attributed to the stock of the selling foreign corporate shareholder owned by a section 1248 shareholder. See paragraph (b)(7), *Example 7* of this section.

(6) *Special rule regarding section 381.* Solely for purposes of determining the earnings and profits (or deficit in earnings and profits) attributable to stock pursuant to this paragraph (b), the earnings and profits of a corporation shall not include earnings and profits that are treated as received or incurred under section 381(c)(2)(A) and §1.381(c)(2)–1(a). See paragraph (b)(7), *Example 4* of this section.

(7) *Examples.* The application of this paragraph (b) is illustrated by the following examples. Unless otherwise indicated, in the following examples assume that—

(i) There is no immediate gain recognition pursuant to section 367(a)(1) and the regulations under that section (either through operation of the rules or because the appropriate parties have entered into a gain recognition agreement under §§1.367(a)–3(b) and 1.367(a)–8);

(ii) There is no income inclusion required pursuant to section 367(b) and the regulations under that section, and all reporting requirements in those regulations are complied with;

(iii) References to earnings and profits are to earnings and profits that would be includible in income as a dividend under section 1248 and the regulations under that section if stock to which the earnings and profits are attributable were sold or exchanged by its shareholder;

(iv) Each corporation has only a single class of stock outstanding and uses the calendar year as its taxable year; and

(v) Each transaction is unrelated to all other transactions.

Example 1. A section 351 exchange of property other than stock in a foreign corporation with respect to which the exchanging shareholder is either a section 1248 shareholder or a foreign corporate shareholder. (i) *Facts.* DC1, a domestic corporation, has owned all the stock of CFC, a foreign corporation, since CFC's formation on January 1, year 3. On December 31, year 5, DC2, a domestic corporation unrelated to DC1, contributes property it has held since January 1, year 1, to CFC in exchange for voting stock of CFC in a restructuring transaction that is an exchange under section 351. The property that DC2 contributes is not stock in a foreign corporation with respect to which DC2 was either a section 1248 shareholder or a foreign corporate shareholder. DC2 receives 80% of the voting stock of CFC in the restructuring transaction and its holding period in that CFC stock, determined pursuant to section 1223(1), began on January 1, year 1. CFC has $100 of accumulated earnings and profits on December 31, year 5. On December 31, year 7, when the accumulated earnings and profits of CFC are $200, DC2, a section 1248 shareholder with respect to CFC, sells its CFC stock.

(ii) *Analysis.* Under paragraph (b)(2)(i) of this section, the earnings and profits attributable to the CFC stock sold by DC2 are $80. This amount consists of none of the $100 of earnings and profits accumulated by CFC before the restructuring transaction, and 80% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

Example 2. A section 351 exchange of controlled foreign corporation stock by a United States person for stock in a controlled foreign corporation in a restructuring transaction. (i) *Facts.* The facts are the same as in *Example 1* except as follows. The property that DC2 contributes is 100% of the stock in CFC2, a foreign corporation. DC2 has owned all the stock of CFC2 since CFC2's formation on January 1, year 2, and CFC2 has $200 of earnings and profits as of December 31, year 5. CFC2 does not accumulate any additional earnings and profits from December 31, year

5, to December 31, year 7. On December 31, year 7, when the accumulated earnings and profits of CFC are $200, DC2, a section 1248 shareholder with respect to CFC, sells its CFC stock. Also on that date, DC1 sells its CFC stock.

(ii) *Analysis*. (A) *DC2 sale*. Pursuant to paragraph (b)(2)(ii) of this section, the earnings and profits attributable to the CFC stock sold by DC2 are $280. This amount consists of all of the $200 of earnings and profits of CFC2 accumulated before the restructuring transaction (see also section 1248(c)(2)), none of the $100 of earnings and profits accumulated by CFC before the restructuring transaction, and 80% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

(B) *DC1 sale*. Pursuant to paragraph (b)(4) of this section, the earnings and profits attributable to the CFC stock sold by DC1, a non-exchanging shareholder in the restructuring transaction, are $120. This amount consists of all of the $100 of earnings and profits of CFC accumulated before the restructuring transaction, none of the $200 of earnings and profits of CFC2 accumulated before the restructuring transaction, and 20% of the $100 of earnings and profits of CFC accumulated after the restructuring transaction.

Example 3. A section 351 exchange of controlled foreign corporation stock by a United States person for stock in a domestic corporation in a restructuring transaction. (i) *Facts*. DC1, a domestic corporation, has owned all of the stock of CFC, a foreign corporation, since CFC's formation on January 1, year 1. DC1 has also owned all the stock of DC2, a domestic corporation, since DC2's formation on January 1, year 1. On December 31, year 2, DC1 contributes the stock of CFC to DC2 in exchange for stock in DC2 in a restructuring transaction that is an exchange described in section 351. On December 31, year 2, CFC has $100 of accumulated earnings and profits. DC2 has a basis in the CFC stock determined under section 362, and is considered to have held the CFC stock since January 1, year 1, pursuant to section 1223(2). On December 31, year 4, when the accumulated earnings and profits of CFC are still $100, DC2 sells its CFC stock.

(ii) *Analysis*. Under paragraph (b)(3)(ii) of this section, $100 of accumulated earnings and profits of CFC is attributable to the stock of CFC sold by DC2, even though DC2 did not hold the stock of CFC during the time CFC accumulated the earnings and profits.

Example 4. Acquisition of a controlled foreign corporation by a controlled foreign corporation in a reorganization described in section 368(a)(1)(C) (or section 368(a)(1)(B)). (i) *Facts*. DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. DC2, a domestic corporation unrelated to DC1, has owned all of the stock of CFC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that is a reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets to CFC2 in exchange for 25% of the voting stock of CFC2. CFC1 distributes the CFC2 stock to DC1 and the CFC1 stock is cancelled. DC1's holding period in the CFC2 stock, determined under section 1223(1), begins on January 1, year 1. On December 31, year 3, CFC1 has $100 of accumulated earnings and profits and CFC2 has $200 of accumulated earnings and profits. CFC2 succeeds to the $100 of CFC1 accumulated earnings and profits in the reorganization under section 381. From January 1, year 4 to December 31, year 5, CFC2 incurred a deficit in earnings and profits in the amount of ($200). On December 31, year 5, both DC1 and DC2 sell their stock in CFC2.

(ii) *Analysis*. (A) *DC1*. Pursuant to paragraph (b)(2)(ii) of this section, $50 of earnings and profits is attributable to the CFC2 stock sold by DC1. This amount consists of $100 of CFC1's earnings and profits accumulated before the restructuring transaction, reduced by 25% of CFC2's ($200) post-restructuring transaction deficit in earnings and profits. None of the $200 of CFC2's earnings and profits accumulated by CFC2 prior to the reorganization is attributed to the CFC2 stock sold by DC1. Also, none of the earnings and profits CFC2 succeeded to under section 381 is attributed to the CFC2 stock sold by DC1, pursuant to paragraph (b)(6) of this section.

(B) *DC2*. Pursuant to paragraph (b)(4) of this section, there is $50 of accumulated earnings and profits attributable to the CFC2 stock sold by DC2. This amount consists of all of the $200 of CFC2's earnings and profits accumulated by CFC2 prior to the reorganization, reduced by 75% of CFC2's deficit in earnings and profits in the amount of ($200) incurred after the restructuring transaction. None of the $100 of CFC1 accumulated earnings and profits succeeded to under section 381 is attributable to the CFC2 stock sold by DC2, pursuant to paragraph (b)(6) of this section.

(C) *Section 368(a)(1)(B) reorganization*. If, instead of DC1 acquiring its 25% interest in CFC2 pursuant to a reorganization described in section 368(a)(1)(C), DC1 had transferred the stock of CFC1 to CFC2 in exchange for 25% of the voting stock of CFC2 in a reorganization described in section 368(a)(1)(B), the results would be the same as described in paragraphs (ii) (A) and (B) of this *Example 4*.

Example 5. Acquisition of the stock of a foreign corporation that controls a domestic acquiring corporation in a triangular reorganization described in section 368(a)(1)(C). (i) *Facts*. DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of DC2, a domestic corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to DC2 in exchange for 60% of the voting stock of FC. CFC1 transferred the voting stock of FC to DC1 and the CFC1 stock was cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), DC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits, CFC2 has $300 of earnings and profits, and FC has $200 of earnings and profits. DC1 includes the $100 all earnings and profits amount attributable to its CFC1 stock in income as a deemed dividend under §1.367(b)–3 upon the exchange of CFC1 stock for FC stock. Pursuant to the lower tier earning exclusion of §1.367(b)–2(d)(3)(ii), that amount does not include the $300 of earnings and profits of CFC2. From January 1, year 4, until December 31, year 5, FC (now a controlled foreign corporation) accumulates an additional $50 of earnings and profits. From January 1, year 4 until December 31, year 5, CFC2 accumulates an additional $100 of earnings and profits. On December 31, year 5, DC1 sells its stock in FC and DC2 sells its stock in CFC2.

(ii) *Analysis*. (A) *DC1*. Pursuant to paragraph (b)(2)(iii) of this section, there is $30 of earnings and profits attributable to the stock of FC sold by DC1. This amount consists of 60% of the $50 of earnings and profits accumulated by FC after the restructuring transaction, and none of the earnings and profits accumulated by CFC1, CFC2, or FC before the restructuring transaction.

(B) *DC2*. Pursuant to paragraph (b)(3)(ii) of this section, there is $400 of earnings and profits attributable to the stock of CFC2 sold by DC2. This amount consists of all of the earnings and profits accumulated by CFC2 during DC2's section 1223(2) holding period.

Example 6. Acquisition of the stock of a foreign corporation that controls a foreign acquiring corporation in a reorganization described in section 368(a)(1)(C). (i) *Facts*. DC1, a domestic corporation, has owned all the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. FC, a foreign corporation that is not a controlled foreign corporation, has owned all of the stock of FC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that was a triangular reorganization described in section 368(a)(1)(C), CFC1 transfers all of its assets, including the CFC2 stock, to FC2 in exchange for 60% of the voting stock of FC. CFC1 transferred the voting stock of FC to DC1 and the CFC1 stock was cancelled. Pursuant to section 1223(1), DC1 is considered to have held the stock of FC since January 1, year 1. Under section 1223(2), FC2 is considered to have held the stock of CFC2 since January 1, year 1. On December 31, year 3, CFC1 has $100 of earnings and profits, CFC2 has $300 of earnings and profits, FC has $200 of earnings and profits, and FC2 has no earnings and profits. From January 1, year 4, until December 31, year 5, FC (now a controlled foreign corporation) accumulates an additional $50 of earnings and profits. From January 1, year 4 until December 31, year 5, CFC2 accumulates an additional $100 of earnings and profits. FC2, a controlled foreign corporation after the restructuring transaction, accumulates $100 of earnings and profits from January 1, year 4, until December 31, year 5. On December 31, year 5, DC1 sells its stock in FC.

(ii) *Analysis*. Pursuant to paragraphs (b)(2)(ii) and (b)(4)(iii) of this section, there is $550 of earnings and profits attributable to the stock of FC sold by DC1. This amount consists of all $400 of the CFC1 and CFC2 earnings and profits accumulated before the restructuring transaction (see also section 1248(c)(2)), and 60% of the $250 of the earnings and profits accumulated by FC, FC2, and CFC2 after the restructuring transaction.

Example 7. Acquisition of controlled foreign corporation stock by a controlled foreign corporation in a reorganization described in section 368(a)(1)(B), followed by a sale of the acquired stock by the acquiring controlled foreign corporation. (i) *Facts.* DC1, a domestic corporation, has owned all of the outstanding stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 has owned all of the outstanding stock of CFC3, a foreign corporation, since its formation on January 1, year 1. DC2, a domestic corporation unrelated to DC1, has owned all of the outstanding stock of CFC2, a foreign corporation, since its formation on January 1, year 2. On December 31, year 3, pursuant to a restructuring transaction that is a reorganization described in section 368(a)(1)(B), CFC1 transfers all of the stock of CFC3 to CFC2 in exchange for 40% of CFC2's stock. On December 31, year 3, CFC2 and CFC3 have, respectively, $40 and $20 of earnings and profits. On December 31, year 5, when the accumulated earnings and profits of CFC3 are $50 ($20 of earnings and profits as of December 31, year 3, plus $30 of earnings and profits generated from January 1, year 4, through December 31, year 5), CFC2 sells the stock of CFC3 in a transaction to which section 964(e) applies.

(ii) *Analysis.* (A) *CFC2.* Pursuant to paragraph (b)(3)(ii) of this section, there is $50 of earnings and profits attributable to the CFC3 stock sold by CFC2. This amount consists of the accumulated earnings and profits attributable to CFC2's entire section 1223(2) holding period in the CFC3 stock.

(B) *CFC1, DC2, and DC1.* Under paragraph (b)(5) of this section, the earnings and profits attributable to the CFC2 stock held by CFC1 and DC2, and the earnings and profits attributable to the CFC1 stock held by DC1, will be reduced (regardless of whether CFC2 recognizes gain on its sale of CFC3 stock).

(*1*) *CFC1.* The earnings and profits attributable to the CFC2 stock held by CFC1 will be reduced by $32, or the amount of earnings and profits as of December 31, year 5, that would have been attributable to the CFC2 stock held by CFC1 pursuant to paragraph (b)(2)(ii) of this section. This amount consists of all of the $20 of earnings and profits accumulated by CFC3 before the restructuring transaction and 40% of the $30 of earnings and profits accumulated by CFC3 after the restructuring transaction (.40 X $30 = $12).

(*2*) *DC1.* The earnings and profits attributable to the CFC1 stock held by DC1 will also be reduced by $32, or the amount of earnings and profits that would have been attributable to the CFC1 stock held by DC1 as of December 31, year 5.

(*3*) *DC2.* The earnings and profits attributable to the CFC2 stock held by DC2 will be reduced by $18, or the amount of earnings and profits that would have been attributable to the CFC2 stock held by DC2 as of December 31, year 5, under paragraph (b)(4) of this section. This amount consists of 60% of the $30 (.60 X $30 = $18) of earnings and profits accumulated by CFC3 after the restructuring transaction.

(C) *Partial sale by CFC2.* If, instead of selling 100% of the CFC3 stock, on December 31, year 5, CFC2 sells only 50% of its CFC3 stock, paragraph (b)(5) of this section requires CFC1 to reduce the earnings and profits of CFC3 attributable to its CFC2 stock to $16. Similarly, DC1 would be required to reduce the earnings and profits of CFC3 attributable to its CFC1 stock by $16. Paragraph (b)(5) of this section also requires DC2 to reduce the CFC3 earnings and profits attributable to its CFC2 stock by $9. These reductions occur without regard to whether CFC2 recognizes gain on its sale of CFC3 stock.

Example 8. Acquisition of the assets of a lower-tier controlled foreign corporation by an upper-tier controlled foreign corporation in a restructuring transaction described in section 368(a)(1)(C). (i) *Facts.* DC, a domestic corporation, has owned all the stock of CFC1, a controlled foreign corporation, since its formation on January 1, year 1. CFC1 is a holding company that has owned 79% of the stock of CFC2, a controlled foreign corporation, since its formation on January 1, year 1. The other 21% of CFC2 stock is owned by X, an unrelated party. On December 31, year 1, CFC2 has $200 of earnings and profits. On December 31, year 1, CFC1 has no accumulated earnings and profits. On December 31, year 1, pursuant to a restructuring transaction described in section 368(a)(1)(C), CFC2 transfers all its properties to CFC1. In exchange, CFC1 assumes the liabilities of CFC2 and transfers to CFC2 voting stock representing 21% of the stock of CFC1. CFC2 distributes the voting stock to X and liquidates. The liabilities assumed do not exceed 20% of the value of the properties of CFC2. From January 1, year 2, to December 31, year 3, CFC1 accumulates $100 of earnings and profits. On December 31, year 3, DC sells its CFC1 stock.

(ii) *Analysis.* Pursuant to paragraphs (b)(4)(ii) of this section, there is $237 of earnings and profits attributable to DC's CFC1 stock. This amount consists of 79% of CFC2's $200 of earnings and profits accumulated before the restructuring transaction (see section 1248(c)(2)), and 79% of CFC1's $100 of earnings and profits accumulated after the restructuring transaction. Pursuant to paragraph (b)(6) of this section, none of CFC2's $200 of earnings and profits to which CFC1 succeeded under section 381 would be attributable to DC's CFC1 stock.

(c) *Earnings and profits attributable to stock of a foreign distributee corporation that is a foreign corporate shareholder with respect to a foreign liquidating corporation*—(1) *General rule.* If a foreign corporation (liquidating corporation) makes a distribution of property in complete liquidation under section 332 to a foreign corporation (distributee), and immediately before the liquidation the distributee was a foreign corporate shareholder with respect to the liquidating foreign corporation, the amount of earnings and profits attributable to the distributee stock, upon its subsequent sale or exchange will be determined under this paragraph (c)(1). The earnings and profits attributable will be the sum of the earnings and profits attributable to the stock of the distributee immediately before the liquidation (including amounts attributed under section 1248(c)(2)) and the earnings and profits attributable to the stock of the distributee accumulated after the liquidation (including amounts attributed under section 1248(c)(2)).

(2) *Special rule regarding section 381.* Solely for purposes of determining the earnings and profits (or deficit in earnings and profits) attributable to stock under this paragraph (c), the attributed earnings and profits of a corporation shall not include earnings and profits that are treated as received or incurred pursuant to section 381(c)(2)(A) and §1.381(c)(2)–1(a).

(3) *Example.* (i) *Facts.* DC, a domestic corporation, has owned all of the stock of CFC1, a foreign corporation, since its formation on January 1, year 1. CFC1 is an operating company that has owned all of the stock of CFC2, a foreign corporation, since its formation on January 1, year 1. On December 31, year 2, CFC1 has $200 of accumulated earnings and profits and CFC2 has a ($200) deficit in earnings and profits. On December 31, year 2, CFC2 distributes all of its assets and liabilities to CFC1 in a liquidation to which section 332 applies. From January 1, year 3, until December 31, year 4, CFC1 accumulates no additional earnings and profits. On December 31, year 4, DC sells its stock in CFC1.

(ii) *Analysis.* Pursuant to paragraph (c)(1) of this section, there are no earnings and profits attributable to DC's CFC1 stock. This amount consists of the sum of the earnings and profits attributable to the CFC1 stock immediately before the liquidation (100% of the $200 accumulated earnings and profits of CFC1 and 100% of CFC2's ($200) deficit in earnings and profits) and the amount of earnings and profits accumulated after the section 332 liquidation (see also section 1248(c)(2)).

(d) *Effective date.* This section applies to income inclusions that occur on or after the date these regulations are published as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on June 1, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 2, 2006, 71 F.R. 31985)

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

Guidance Under Section 7874 Regarding Expatriated Entities and Their Foreign Parents

REG–112994–06

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9265) relating to the determination of whether a foreign entity shall be treated as a surrogate foreign corporation under section 7874(a)(2)(B) of the Code. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by September 5, 2006. Outlines of topics to be discussed at the public hearing scheduled for October 24, 2006, at 10 a.m., must be received by October 3, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–112994–06), 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–112994–06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at: *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov* (IRS-REG–112994–06). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Milton Cahn at (202) 622–3860; concerning submission and delivery of comments and the public hearing, Treena Garrett, (202) 622–7180 (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 7874. The temporary regulations set forth rules relating to the determination of whether a foreign entity shall be treated as a surrogate foreign corporation under section 7874(a)(2)(B) of the Code. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6), it is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. Accordingly, a regulatory flexibility analysis is not required. The nature of the businesses that are most likely to consider corporate expatriation transactions, as well as the complexity and the costs of structuring and implementing those transactions, makes it unlikely that a substantial number of small entities will engage in such transactions. In addition, any economic impact to entities affected by section 7874, large or small, is derived from the operation of the statute or its intended application, not the proposed regulations in this notice of proposed rulemaking. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

A public hearing has been scheduled for October 24, 2006, at 10 a.m., in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by September 5, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Jefferson VanderWolk of the Office of the Associate Chief Counsel (International). 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 is amended by adding an entry in numerical order to read, in part, as follows:

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

Section 1.7874–2 also issued under 26 U.S.C. 7874(c)(6) and (g). * * *

Par. 2. Section 1.7874–2 is added to read as follows:

§1.7874–2 Surrogate foreign corporation.

[The text of proposed §1.7874–2 is the same as the text of §1.7874–2T 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 June 5, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 6, 2006, 71 F.R. 32495)

Designated Roth Accounts Under Section 402A; Hearing

Announcement 2006–42

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of public hearing on proposed rulemaking.

SUMMARY: This document provides notice of public hearing on proposed regulations under sections 402(g), 402A, 403(b), and 408A of the Internal Revenue Code (Code) relating to designated Roth accounts.

DATES: The public hearing is being held on Wednesday, July 26, 2006, at 10 a.m. The IRS must receive outlines of the topics to be discussed at the hearing by Wednesday, July 5, 2006.

ADDRESSES: The public hearing is being held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Send submissions to: CC:PA:LPD:PR (REG–146459–05), room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–146459–05), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic outlines of oral comments via the IRS internet site at *www.irs.gov/regs* or via the Federal eRulemaking Portal at *www.regulations.gov*.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, R. Lisa Mojiri-Azad, 202–622–6060 or Cathy A. Vohs, 202–622–6090; Concerning the submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst at *Richard.A.Hurst@irscounsel.treas.gov* or (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

The subject of the public hearing is the notice of proposed rulemaking (REG–146459–05, 2006–8 I.R.B. 504) that was published in the **Federal Register** on Thursday, January 26, 2006 (71 FR 4320).

The rules of 26 CFR 601.601(a)(3) applies to the hearing. Persons who wish to present oral comments at the hearing that submitted written comments by April 26, 2006, must submit an outline of the topics to be discussed and the amount of time to be devoted to each topic (signed original and eight (8) copies) by July 5, 2006.

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

Because of access restrictions, the IRS will not admit visitors 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 document.

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

(Filed by the Office of the Federal Register on June 7, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 8, 2006, 71 F.R. 33273)

Renewal of Tax Exempt Bond Mediation Dispute Resolution Pilot Program

Announcement 2006–43

SUMMARY AND BACKGROUND

This announcement renews the Tax Exempt Bond Mediation Pilot Program set forth in Announcement 2003–36, 2003–1 C.B. 1093, for an additional one-year period, beginning on the date this announcement is published in the Internal Revenue Bulletin.

TEB and Appeals concluded a two-year test of the Tax Exempt Bond Mediation Pilot Program on June 3, 2005. During the additional one-year test period, TEB and Appeals will seek additional cases for mediation to further evaluate the program. The renewed program will follow the provisions of Ann. 2003–36.

This procedure allows Issuers of tax-exempt debt with cases under examination by the Tax Exempt Bond (TEB) organization to request mediation as permitted under Announcement 2003–36. Using the services of a trained mediator from the Office of Appeals, with the option of using a non-Service co-mediator, the Issuer and TEB will attempt to resolve unagreed issues on an expedited basis prior to the issuance of a proposed adverse determination letter. The mediation program is consistent with the Internal Revenue Service's efforts to improve tax administration, provide customer service, and reduce taxpayer burden.

EFFECTIVE DATE

This program is effective beginning on the date it is published in the Internal Revenue Bulletin.

COMMENTS

The Service invites interested persons to comment on this pilot program. Written comments on the announcement should be delivered or mailed to:

Internal Revenue Service
Office of the Chief, Appeals
1099 14th Street, NW
Suite 4035- East
Washington, D.C. 20005

Alternatively, comments may be submitted by e-mail to the following address: *notice.comments@irscounsel.treas.gov*.

FURTHER INFORMATION

For further information regarding this announcement, contact Jacqueline A. Harris, Appeals TEB Mediation Program Manager at (972) 308–7330; Charles F. Fisher, Appeals Team Manager (TEGE Programs) at (302) 792–6658; and Joseph Ali (Appeals Area Director) at (215) 597–4118 (not toll-free calls).

Guidance Under Section 1502; Suspension of Losses on Certain Stock Dispositions; Correction

Announcement 2006–44

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 9254, 2006–13 I.R.B. 662) that were published in the **Federal Register** on Tuesday, March 14, 2006 (71 FR 13008). The regulations apply when a member of a consolidated group transfers subsidiary stock at a loss. They also apply when a member holds loss shares of subsidiary stock and the subsidiary ceases to be a member of the group.

DATES: This correction is effective March 14, 2006.

FOR FURTHER INFORMATION CONTACT: Theresa Abell (202) 622–7700 or Martin Huck (202) 622–7750 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

The final regulations (T.D. 9254) that are the subject of this correction are under section 1502 of the Internal Revenue Code.

Need for Correction

As published, final regulations (T.D. 9254) contains an error that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the final regulations (T.D. 9254) which was the subject of FR Doc. 06–2411, is corrected as follows:

On page 13009, column 2, in the preamble, under the paragraph heading "Special Analyses", line 4 from the bottom of the paragraph, the language "these regulations was submitted to the" is corrected to read "these regulations were submitted to the".

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

(Filed by the Office of the Federal Register on June 7, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 8, 2006, 71 F.R. 33239)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

Numerical Finding List[1]

Bulletin 2006–27

Announcements:

2006-42, 2006-27 I.R.B. *48*
2006-43, 2006-27 I.R.B. *48*
2006-44, 2006-27 I.R.B. *49*

Notices:

2006-57, 2006-27 I.R.B. *13*

Proposed Regulations:

REG-135866-02, 2006-27 I.R.B. *34*
REG-112994-06, 2006-27 I.R.B. *47*

Revenue Procedures:

2006-29, 2006-27 I.R.B. *13*
2006-31, 2006-27 I.R.B. *32*

Treasury Decisions:

9265, 2006-27 I.R.B. *1*

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

Finding List of Current Actions on Previously Published Items[1]

Bulletin 2006–27

Revenue Procedures:

2005-41
Superseded by
Rev. Proc. 2006-29, 2006-27 I.R.B. *13*

Treasury Decisions:

9254
Corrected by
Ann. 2006-44, 2006-27 I.R.B. *49*

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

United States Government INFORMATION
PUBLICATIONS ★ PERIODICALS ★ ELECTRONIC PRODUCTS

Internal Revenue Cumulative Bulletins Publications and Subscription Order Form

Order Processing Code: 3432

Easy Secure Internet: bookstore.gpo.gov

Toll Free: 866 512-1800
DC Area: 202 512-2800
Fax: 202 512-2250

Mail: Superintendent of Documents
P.O. Box 371954
Pittsburgh, PA 15250-7954

Publications

Qty.	Stock Number	Title	Price Each	Total Price
	048–004–02405–5	Cum. Bulletin 1998–1 (Jan-June)	86.00	
	048–004–02422–5	Cum. Bulletin 1998–2 (Jul-Dec)	85.00	
	048–004–02451–9	Cum. Bulletin 1998–4	72.50	
	048–004–02467–5	Cum. Bulletin 1999–3	51.00	
	048–004–02455–1	Cum. Bulletin 2000–1 (Jan–June)	82.00	
	048–004–02453–5	Cum. Bulletin 2000–2 (July–Dec)	58.00	
	048–004–02454–3	Cum. Bulletin 2001–1 (Jan-June)	83.00	
	048–004–02462–4	Cum. Bulletin 2001–2 (July–Dec)	60.00	
	048–004–02463–2	Cum. Bulletin 2002–1 (Jan-June)	78.00	
	048–004–02470–5	Cum. Bulletin 2002–2 (July–Dec)	72.00	
			Total for Publications	

Subscriptions

Qty.	List ID	Title	Price Each	Total Price
	IRS	Internal Revenue Bulletin	$247	
		Optional – Add $50 to open Deposit Account		
			Total for Subscriptions	
			Total for Publications and Subscriptions	

[redacted]

Check method of payment:

❑ Check payable to Superintendent of Documents
❑ SOD Deposit Account ☐☐☐☐☐☐☐–☐
❑ VISA ❑ MasterCard ❑ Discover/NOVUS ❑ AMEX
☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐☐
☐☐☐☐ (expiration date)

Thank you for your Order!

Authorizing signature 08/03

Company or personal name (Please type or print)

Additional address/attention line

Street address

City, State, Zip Code

E-mail address

Daytime phone including area code

Purchase order number (optional)

Standing Order Service*

To automatically receive future editions of *Internal Revenue Cumulative Bulletins* without having to initiate a new purchase order, sign below for Standing Order Service.

Qty.	Standing Order	Title
	ZIRSC	Internal Revenue Cumulative Bulletins

Authorization

I hereby authorize the Superintendent of Documents to charge my account for Standing Order Service:
(enter account information at right)

❑ VISA ❑ MasterCard ❑ Discover/NOVUS ❑ American Express

❑ Superintendent of Documents (SOD) Deposit Account

Authorizing signature (Standing orders not valid unless signed.)

Please print or type your name.

Daytime phone number (_____) _____

SuDocs Deposit Account

A Deposit Account will enable you to use Standing Order Service to receive subsequent volumes quickly and automatically. For an initial deposit of $50 you can establish your Superintendent of Documents Deposit Account.

❑ **YES!** Open a SOD Deposit Account for me so I can order future publications quickly and easily.
I am enclosing the $50 initial deposit.

*Standing Order Service

Just sign the authorization above to charge selected items to your existing Deposit Account, VISA or MasterCard, Discover/NOVUS, or American Express account. Or open a Deposit Account with an initial deposit of $50 or more. Your account will be charged only as each volume is issued and mailed. Sufficient money must be kept in your account to insure that items are shipped. Service begins with the next issue released of each item you select.

You will receive written acknowledgement for each item you choose to receive by Standing Order Service.

If you wish to cancel your Standing Order Service, please notify the Superintendent of Documents in writing (telephone cancellations are accepted, but must be followed up with a written cancellation within 10 days).

Important: Please include this completed order form with your payment.

INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

CUMULATIVE BULLETINS

The contents of this weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

ACCESS THE INTERNAL REVENUE BULLETIN ON THE INTERNET

You may view the Internal Revenue Bulletin on the Internet at www.irs.gov. Under information for: select Businesses. Under related topics, select More Topics. Then select Internal Revenue Bulletins.

INTERNAL REVENUE BULLETINS ON CD-ROM

Internal Revenue Bulletins are available annually as part of Publication 1796 (Tax Products CD-ROM). The CD-ROM can be purchased from National Technical Information Service (NTIS) on the Internet at www.irs.gov/cdorders (discount for online orders) or by calling 1-877-233-6767. The first release is available in mid-December and the final release is available in late January.

HOW TO ORDER

Check the publications and/or subscription(s) desired on the reverse, complete the order blank, enclose the proper remittance, detach entire page, and mail to the Superintendent of Documents, P.O. Box 371954, Pittsburgh PA, 15250–7954. Please allow two to six weeks, plus mailing time, for delivery.

WE WELCOME COMMENTS ABOUT THE INTERNAL REVENUE BULLETIN

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can e-mail us your suggestions or comments through the IRS Internet Home Page (www.irs.gov) or write to the IRS Bulletin Unit, SE:W:CAR:MP:T:T:SP, Washington, DC 20224

Internal Revenue Service
Washington, DC 20224

Official Business
Penalty for Private Use, $300