Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2000–21, page 881.

LIFO; price indexes; department stores. The February 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, February 29, 2000.

Rev. Rul. 2000–22, page 880.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2000. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2000.

REG–100291–00, page 917.

Proposed regulations under section 170 of the Code relate to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. A public hearing is scheduled for June 29, 2000.

REG–107872–99, page 911.

Proposed regulations under section 755 of the Code provide guidance to partnerships and their partners concerning the allocation of basis adjustments among partnership assets. A public hearing is scheduled for July 12, 2000.

EMPLOYEE PLANS

Rev. Rul. 2000–20, page 880.

Amortization bases; Taxpayer Relief Act of 1997. This ruling provides questions and answers relating to the establishment and maintenance of certain amortization bases under section 412 of the Code as amended by section 1521(c) of the Taxpayer Relief Act of 1997.

REG–109101–98, page 903.

Proposed regulations would permit qualified defined contribution plans to be amended to eliminate some alternative forms in which an account balance can be paid, and would permit certain transfers between defined contribution plans that are not permitted under current regulations. A public hearing is scheduled for June 27, 2000.

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Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

ESTATE TAX

REG–100291–00, page 917.
Proposed regulations under section 170 of the Code relate to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. A public hearing is scheduled for June 29, 2000.

EXEMPT ORGANIZATIONS

Announcement 2000–39, page 948.
A list is provided of organizations that no longer qualify as organizations to which contributions are deductible under section 170 of the Code.

GIFT TAX

REG–100291–00, page 917.
Proposed regulations under section 170 of the Code relate to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. A public hearing is scheduled for June 29, 2000.

EXCISE TAX

T.D. 8879, page 882.
Final regulations under section 4081 of the Code relate to kerosene tax. Rev. Ruls. 57-259, 57-499, 73-292, 78-218, and 86-62 obsolete. Announcement 99-40 obsolete.

ADMINISTRATIVE

Notice 2000–22, page 902.
Information returns; discharges of indebtedness; penalties. The Service will not impose penalties under sections 6721 and 6722 of the Code on certain taxpayers for failure to file information returns or furnish payee statements under section 6050P for discharges of indebtedness occurring before January 1, 2001. This notice applies only to taxpayers who were made subject to section 6050P by section 533(a) of the Ticket to Work and Work Incentives Improvement Act of 1999.

Announcement 2000–35, page 922.
This document contains the annual report to the public concerning Advance Pricing Agreements (APAs) and the APA program under section 521(b) of the Ticket to Work and Work Incentives Improvement Act of 1999.

Announcement 2000–36, page 947.
This document contains corrections to final regulations (T.D. 8869, 2000–6 I.R.B. 498) relating to the treatment of corporate subsidiaries of S corporations and interpreting the rules added to the Code by section 1308 of the Small Business Job Protection Act of 1996.

Announcement 2000–37, page 947.
This document contains corrections to final regulations (T.D. 8865, 2000–7 I.R.B. 589) relating to the amortization of certain intangible property.

Announcement 2000–38, page 948.
This document contains a correction to proposed regulations (REG–100276–97, 2000–8 I.R.B. 682) relating to financial asset securitization investment trusts (FASITs) and real estate mortgage investment conduits (REMICs).

Announcement 2000–40, page 948.
This document contains corrections to proposed regulations (REG–209601–92, 2000–12 I.R.B. 829) relating to the tax treatment of sponsorship payments received by exempt organizations.

Announcement 2000–41, page 949.
This document contains corrections to proposed regulations (REG–113572–99, 2000–7 I.R.B. 624) relating to qualified transportation fringe benefits.

Announcement 2000–42, page 949.
This document contains a partial withdrawal of the notice of proposed rulemaking (PS–6–95 [1996–1 C.B. 859]; REG–209753–95) as it relates to diesel fuel dye injection systems.

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 consolidated 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 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 first 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 first Bulletin of the succeeding semiannual period, respectively.

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

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period January through March 2000. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period January through March 2000.

Rev. Rul. 2000–22

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period January through March 2000.

Table 1
Rev. Rul. 2000–22
Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year													
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Jan'00	30.47	45.13	60.05	75.18	77.88	81.14	84.50	87.80	91.16	94.79	98.62	102.80	106.78	107.43
Feb'00	30.47	45.13	60.05	75.18	77.65	80.89	84.23	87.51	90.85	94.45	98.24	102.37	106.23	107.43
Mar'00	30.47	45.13	60.05	75.18	77.42	80.65	83.97	87.23	90.55	94.13	97.89	101.97	105.76	107.43

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul.98–3, 1998–1 C.B. 248, for dispositions occurring during the calendar years 1996 and 1997; Rev. Rul. 98–13, 1998–1 C.B. 686, for dispositions occurring during the period January through March 1998; Rev. Rul. 98–31, 1998–1 C.B. 1269, for dispositions occurring during the period April through June 1998; Rev. Rul. 98–45, 1998–2 C.B. 364, for dispositions occurring during the period July through September 1998; Rev. Rul. 99–1, 1999–2 I.R.B. 4, for dispositions occurring during the period October through December 1998; and Rev. Rul. 99–54, 1999–51 I.R.B. 675, for dispositions occurring during the calendar year 1999.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran on (202) 622-3040 (not a toll-free call).

Section 412.—Minimum Funding Standards

Amortization bases; Taxpayer Relief Act of 1997. This revenue ruling provides questions and answers relating to the establishment and maintenance of certain amortization bases under section 412 of the Code as amended by section 1521(c) of the Taxpayer Relief Act of 1997.

Rev. Rul. 2000–20

PURPOSE

This revenue ruling provides questions and answers relating to the establishment and maintenance of certain amortization bases under § 412(b) of the Internal Revenue Code (the "Code"), as amended by § 1521(c) of the Taxpayer Relief Act of 1997 ("TRA '97").

BACKGROUND

Section 412 of the Code imposes minimum funding requirements with respect to defined benefit and money purchase pension plans. Under § 412(a), a plan will have satisfied the minimum funding requirements for a plan year if as of the end of the plan year, the plan does not have an accumulated funding deficiency in the funding standard account. Section 412(b)(1) provides that each plan to which § 412 applies shall establish and maintain a funding standard account. Sections 412(b)(2) and (3) provide for charges and credits to the funding standard account.

Section 412(c)(7) provides a full funding limitation for defined benefit plans for purposes of the minimum funding requirements. Section 412(c)(7)(A)(i)(I) provides that one component of the full funding limitation is the applicable per-

centage of current liability (including the expected increase in current liability due to benefits accruing during the plan year). Section 412(c)(6)(A) provides for a credit to the funding standard account for contributions that would be required but for the full funding limitation.

Prior to TRA '97, the current liability component of the full funding limitation was 150 percent of current liability (including the expected increase in current liability due to benefits accruing during the plan year), and § 412(c)(7)(D)(iii) provided that the Secretary may provide for the treatment under § 412 of contributions that would be required to be made under the plan but for the provisions of § 412(c)(7)(A)(i)(I).

Section 1521(c)(1) of TRA '97 added § 412(b)(2)(E) to the Code to provide that contributions that would have been required under § 412 but for the provisions of § 412(c)(7)(A)(i)(I) are to be amortized over a 20 year period. Section 1521(c)(3) of TRA '97 repealed § 412(c)(7)(D)(iii) of the Code. Section 1521(d)(1) of TRA '97 provides that the amendments made by § 1521 apply to plan years beginning after December 31, 1998.

Section 1521(d)(2) of TRA '97 provides that the unamortized balance (as of the close of the plan year preceding the plan's first plan year beginning in 1999) of any amortization base established under § 412(c)(7)(D)(iii) of the Code (prior to its repeal by § 1521(c)(3) of TRA '97) is amortized in equal annual installments (until fully amortized) over a period of years equal to the excess of (A) 20 years, over (B) the number of years since the amortization base was established.

QUESTIONS AND ANSWERS RELATING TO § 412(b)(2)(E) OF THE CODE

Q-1. How are contributions that would have been required under § 412 but for the provisions of § 412(c)(7)(A)(i)(I) treated?

A-1. In general, for purposes of § 412, an amortization base is established for contributions that would have been required under § 412 but for the provisions of § 412(c)(7)(A)(i)(I). The amortization base is established for the plan year following the plan year for which the contributions would have been required under § 412 but for the provisions of §412(c)(7)(A)(i)(I). For amortization bases that were established for plan years beginning before January 1, 1999, the amortization period is 10 years. For amortization bases established for plan years beginning after December 31, 1998, the amortization period is 20 years. Any such amortization base is maintained in the same manner as other amortization bases established under § 412. No corresponding amortization base is established for purposes of § 404.

Q-2. How are amortization bases described in Q&A-1 that were established for plan years beginning before January 1, 1999, treated for the first plan year beginning after December 31, 1998?

A-2. In general, under § 1521(d)(2) of TRA '97, the remaining amortization period for any amortization base described in Q&A-1 that was established for plan years beginning before January 1, 1999, ("existing 10-year base") is increased as of the first plan year beginning after December 31, 1998, by adding 10 to the number of years that was otherwise remaining in the amortization period, provided that the amortization base has not been combined with other amortization bases. For the first plan year beginning after December 31, 1998, the amortization charge for such existing 10-year base is redetermined as the amount necessary to amortize the unamortized balance (as of the close of the plan year preceding the plan's first plan year beginning in 1999) in equal annual installments (until fully amortized) over this increased amortization period. Thereafter, these amortization bases are maintained in the same manner as other amortization bases established under § 412 of the Code.

Q-3. Are there any special rules with respect to funding methods that do not provide for amortization bases?

A-3. Yes. If the funding method does not provide for amortization bases, no amortization base is established for plan years beginning after December 31, 1998, for contributions that would have been required under § 412 but for the provisions of § 412(c)(7)(A)(i)(I). Also, except as provided in Q&A-4, existing 10-year bases are treated as fully amortized for the first plan year beginning after December 31, 1998. For purposes of this revenue ruling, a funding method does not provide for amortization bases if the funding method is a spread gain method that does not use an unfunded liability in determining the normal cost. A spread gain method is any funding method that does not directly calculate an accrued liability. See Rev. Rul. 81–13, 1981–1 C.B. 229, for whether a funding method directly calculates an accrued liability.

Q-4. Is there a transition rule for the first plan year beginning after December 31, 1998, for plans using a funding method that does not provide for amortization bases?

A-4. Yes, as an optional transition rule, for plans using a funding method described in Q&A-3, any existing 10-year bases may be continued for the first plan year beginning after December 31, 1998, but the amortization period is increased as described in Q&A-2. Furthermore, in such a case, a new 20-year amortization base as described in Q&A-1 is permitted to be established for that plan year. However, in any event, if the transition rule described in this Q&A-4 is used for the first plan year beginning after December 31, 1998, the existing 10-year bases (and any amortization base described in Q&A-1 established for that plan year) are treated as fully amortized pursuant to Q&A-3 for the next plan year.

DRAFTING INFORMATION

The principal author of this revenue ruling is James Holland of the Tax Exempt and Government Entities Division. For further information concerning this revenue ruling, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday through Thursday. Mr. Holland's number is (202) 622-6730 (also not a toll free number).

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

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

LIFO; price indexes, department stores. The February 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, February 29, 2000.

Rev. Rul. 2000–21

The following Department Store Inventory Price Indexes for February 2000 were issued by the Bureau of Labor Sta-

tistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, February 29, 2000.

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

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

Groups	Feb. 1999	Feb. 2000	Percent Change from Feb. 1999 to Feb. 2000[1]
1. Piece Goods	496.2	502.6	1.3
2. Domestics and Draperies	643.1	611.8	-4.9
3. Women's and Children's Shoes	632.3	612.7	-3.1
4. Men's Shoes	889.8	893.0	0.4
5. Infants' Wear	619.6	648.8	4.7
6. Women's Underwear	565.8	577.0	2.0
7. Women's Hosiery	320.0	330.8	3.4
8. Women's and Girls' Accessories	549.6	542.1	-1.4
9. Women's Outerwear and Girls' Wear	380.3	381.7	0.4
10. Men's Clothing	617.4	622.6	0.8
11. Men's Furnishings	592.2	619.2	4.6
12. Boys' Clothing and Furnishings	478.3	496.2	3.7
13. Jewelry	983.3	973.4	-1.0
14. Notions	741.9	763.6	2.9
15. Toilet Articles and Drugs	951.6	967.0	1.6
16. Furniture and Bedding	679.2	700.0	3.1
17. Floor Coverings	602.7	604.0	0.2
18. Housewares	808.2	787.3	-2.6
19. Major Appliances	233.8	233.9	0.0
20. Radio and Television	69.0	61.5	-10.9
21. Recreation and Education[2]	100.1	94.2	-5.9
22. Home Improvements[2]	129.8	128.1	-1.3
23. Auto Accessories[2]	107.7	107.3	-0.4
Groups 1 - 15: Soft Goods	590.3	593.9	0.6
Groups 16 - 20: Durable Goods	455.6	444.9	-2.3
Groups 21 - 23: Misc. Goods[2]	105.5	101.3	-4.0
Store Total[3]	540.7	537.7	-0.6

[1] Absence of a minus sign before the percentage change in this column signifies a price increase.
[2] Indexes on a January 1986=100 base.
[3] The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Alan J. Tomsic of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic on (202) 622-4970 (not a toll-free call).

Section 4081.—Imposition of Tax

26 CFR 48.4081–1: Taxable fuel; definitions.

T.D. 8879

Kerosene Tax; Aviation Fuel Tax; Taxable Fuel Measurement and Reporting; Tax on Heavy Trucks and Trailers; Highway Vehicle Use Tax

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations; conforming amendments to temporary regulations; and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the kerosene and aviation fuel excise taxes, the tax on the use of certain highway vehicles, and the tax on the first retail sale of certain tractors and truck, trailer, and semitrailer chassis and bodies (highway vehicles). The regulations relating to kerosene affect the tax liability of certain refiners, terminal operators, and persons that sell, buy, or use kerosene. The regulations relating to aviation fuel affect certain producers and retailers of aviation fuel. The regulations relating to the taxes on highway vehicles affect vehicle manufacturers, dealers, and owners.

DATES: *Effective Dates*: These regulations are effective March 31, 2000.

Applicability Dates: For dates of applicability of these regulations, see §§48.4052–1(c), 48.4081–1(f), 48.4081–2(f), 48.4081–3(j), 48.4082–2(c), 48.4082–4(d), 48.4082–5(h), 48.4082–6(f), 48.4082–7(f), 48.4101–1(l), 48.4101–2(b), 48.6427–8(f), 48.6427–9(g), 48.6427–10(h), and 48.6427–11(g).

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

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information in these final regulations have been reviewed in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545-1418.

The collections of information in these regulations are in §§48.4052–1, 48.4081–2, 48.4081–3, 48.4081–7, 48.4082–2, 48.4082–6, 48.4082–7, 48.4091–3, 48.4101–1, 48.4101–2, 48.6427–8, 48.6427–9, 48.6427–10, and 48.6427–11. This information is required to support exempt transactions, claims for credits and refunds, and to inform consumers of the type of fuel that is being purchased. The likely respondents are businesses and other for-profit organizations.

Comments on the collections of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224. Comments on the collections of information should be received by May 30, 2000. Comments are specifically requested concerning:

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

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

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

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

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

Estimated total annual reporting and/or recordkeeping burden: 97,583 hours.

The estimated annual burden per respondent is 17 minutes.

Estimated number of respondents: 346,080.

Estimated annual frequency of responses: On occasion.

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

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

Background

Section 4081 imposes a tax on certain removals, entries, and sales of taxable fuel. Before July 1, 1998, taxable fuel meant gasoline and diesel fuel. As of that date, however, the definition of taxable fuel was expanded by the Taxpayer Relief Act of 1997 (Public Law 105-34, 111 Stat. 788 (the 1997 Act)) to include kerosene.

Temporary regulations (T.D. 8774, 1998–2 C.B. 90) relating to this change were published in the **Federal Register** on July 1, 1998 (63 F.R. 35799) along with a notice of proposed rulemaking (REG–119227–97, 1998–2 C.B. 98) cross-referencing the temporary regulations (63 F.R. 35893). Written comments responding to these proposed regulations were received and a public hearing was held on November 4, 1998.

Proposed regulations (REG–209753–95; PS–6–95, 1996–1 C.B. 859) were published in the **Federal Register** (61 F.R. 10490) on March 14, 1996, relating to, among other things, the measurement of taxable fuel. Written comments responding to these proposed regulations were received and a public hearing was held on June 20, 1996.

After consideration of written comments and comments made at the public hearings, the proposed regulations are adopted as revised by this Treasury decision. Comments and revisions are discussed below. Also, a partial withdrawal of the March 14, 1996, proposed regulations (REG–209753–95; PS–6–95) is published in Announcement 2000–42 on page 949.

Explanation of Provisions

Definition of Kerosene. The temporary regulations define kerosene as the two grades of kerosene (No. 1-K and No. 2-K) described in ASTM specification D 3699 and certain kerosene-type jet fuel. This ASTM specification describes kerosene in terms of several properties including distillation range, sulfur content, and color. For example, No. 1-K kerosene has a sulfur content not greater than 400 parts per million.

Several commentators noted, however, that there are many liquids that are never commercially known or sold as kerosene but that nevertheless might meet the broad specifications of ASTM specification D 3699. These liquids, which are used in the production of products such as paints and coatings, usually cost more to produce than kerosene that is sold for fuel uses. Because of these differences, the commentators concluded that it is highly

unlikely that these liquids would be diverted for use in highway vehicles. Thus, the commentators suggested that these liquids should not be treated as kerosene.

The final regulations adopt the suggestion of the commentators by excluding liquids with certain described properties from the definition of kerosene.

Exemption for Aviation-grade Kerosene. The 1997 Act provides that undyed aviation-grade kerosene may be removed from a terminal tax free if the kerosene is received by a person that is registered for purposes of the aviation fuel tax imposed by section 4091. As a transitional rule, the temporary regulations provide that tax does not apply to a removal of aviation-grade kerosene that will be used as a fuel in an aircraft, even if the person receiving the kerosene is not registered.

The IRS Restructuring and Reform Act of 1998 (Public Law 105-206, 112 Stat. 685 (the 1998 Act)), which was enacted after publication of the temporary regulations, revised the exemption for aviation-grade kerosene. Under the 1998 Act, tax is not imposed on aviation-grade kerosene that the Secretary determines is destined for use as a fuel in an aircraft.

Under the final regulations, existing rules relating to tax-free transactions within the bulk transfer/terminal system will continue to apply to aviation-grade kerosene even if the kerosene will be used as a fuel in an aircraft. Thus, a sale of aviation-grade kerosene within a pipeline to an airline for aircraft use may be made tax free only if the airline is a taxable fuel registrant. In this regard, the final regulations also reflect Announcement 99–40 (1999–16 I.R.B. 10), which provides a transitional registration rule for certain throughputters and kerosene terminal operators.

Removals and entries of undyed aviation-grade kerosene may be made tax free under the final regulations if (1) the person otherwise liable for tax (such as the position holder) delivers the kerosene into the fuel supply tank of its own aircraft or (2) the kerosene is sold and the buyer certifies to the person otherwise liable for tax that the kerosene will be used by the buyer as a fuel in an aircraft or resold for such use. Any later sale of the aviation-grade kerosene will be subject to tax unless the subsequent seller receives a similar certificate from its buyer or delivers the kerosene into the fuel supply tank of the buyer's aircraft. In addition, the IRS may withdraw the right of a buyer to provide a certificate in the future if the buyer uses the aviation-grade kerosene other than as a fuel in an aircraft.

A commentator noted that airlines often use a small percentage of their purchases of aviation-grade kerosene as a fuel in airport ground equipment, thus making it impossible for them to certify that all of this fuel will be for aircraft use. The commentator suggested that a buyer should be allowed to certify that only a percentage of its purchases will be used as a fuel in an aircraft. The final regulations adopt this suggestion. Thus, if an airline certifies to a position holder that 99 percent of all of its purchases of aviation-grade kerosene from a certain terminal will be for use as a fuel in an aircraft, then the position holder will the liable for the section 4081 tax on one percent of all its sales to the airline at that terminal.

A commentator suggested that tax should not be imposed on the nonbulk removal of aviation-grade kerosene from an approved terminal if the kerosene is received at another approved terminal or is sold for use in an aircraft outside the United States. Under the final regulations, both removals may be made tax free if the proper certification regarding aircraft use is given by the buyer or the person otherwise liable for tax delivers the aviation-grade kerosene into the fuel supply tank of its own aircraft.

A commentator noted that aviation-grade kerosene is aviation fuel and thus is subject to tax under section 4091 when it is sold by its producer. Section 4092 exempts a sale from the aviation fuel tax if the buyer is a registered producer or certifies that it will use the fuel in a nontaxable use such as use other than as a fuel in an aircraft.

The commentator suggested that if the section 4081 tax is imposed on the removal of any aviation-grade kerosene because the buyer of the kerosene does not certify that it will be used in an aircraft, then an exemption from the section 4091 tax automatically should apply regardless of the status of the buyer. Thus, for example, if the section 4081 tax is imposed on a removal of aviation-grade kerosene at the terminal rack, the section 4091 tax should not be imposed on any subsequent sale to an unregistered person that buys the kerosene for resale for nonaircraft use, such as in highway vehicles or as heating oil. The commentator contends that this suggestion would ease compliance and administrative burdens by eliminating the need to certify for section 4091 purposes.

The final regulations do not adopt this suggestion because section 4092 allows tax-free sales of aviation fuel only to registered producers and persons buying for their own nontaxable use. This suggestion, in contrast, would allow tax-free sales to resellers that are not producers. The IRS has published guidance regarding the aviation fuel tax imposed by section 4091 in Notice 88–30 (1988–1 C.B. 497), Notice 88–132 (1988–2 C.B. 552), and Notice 89–38 (1989–1 C.B. 678).

Exemption for Feedstock Purpose. Under the 1997 Act and the temporary regulations, tax is not imposed on undyed kerosene that is received from a pipeline or vessel by a registered person for the person's use as a feedstock; that is, use in the manufacture or production of any substance other than gasoline, diesel fuel, or special fuels referred to in section 4041.

The 1997 Act also provides that, to the extent provided in regulations, undyed kerosene may be removed from a terminal tax free if the kerosene is removed for use as a feedstock. The temporary regulations do not implement this latter provision. However, several commentators suggested that, without the application of this provision, small feedstock users that buy kerosene at a terminal rack bear the burden of the tax and then must claim a credit or refund. This puts the small users at a competitive disadvantage compared to larger users that may buy bulk quantities of kerosene tax free for their facilities that are connected to a pipeline.

The final regulations adopt the suggestion of the commentators by generally allowing tax-free removals of kerosene from a terminal if the person receiving the kerosene is registered and certifies that it will use the kerosene for a feedstock purpose. The IRS may revoke this person's registration if the person uses the kerosene other than for a feedstock purpose, such as to power machinery in a factory where paint is produced.

A commentator suggested that the packaging of kerosene into any container

that is less than 55 gallons should be treated as a feedstock purpose. This suggestion is not adopted in the final regulations because this activity is not the manufacture or production of a nonfuel substance.

Exemption for Certain Wholesale Distributors. The 1997 Act provides that, to the extent provided in regulations, undyed kerosene may be removed from a terminal tax free if the kerosene is received by a registered wholesale distributor that sells kerosene exclusively to ultimate vendors that sell kerosene from a pump that is not suitable for use in fueling any diesel-powered highway vehicle or train (a blocked pump). The temporary regulations do not provide rules for this provision.

A commentator suggested that the final regulations should implement this provision because it would reduce the number of refund claims that are filed by ultimate vendors and reduce the costs of the fuel for these vendors, many of whom are small businesses. Another commentator suggested, on the other hand, that the provision would increase the availability of untaxed, undyed kerosene and thus increase opportunities for diversion of this fuel for taxable purposes.

The final regulations do not implement this provision because Treasury and the IRS share the concern of the latter commentator. Treasury and the IRS will, however, continue to monitor the matter to determine if it is appropriate to provide rules for the provision at a later date.

Claims Relating to Sales of Kerosene from Blocked Pumps. Under the 1997 Act, a credit or refund is allowed to a registered ultimate vendor that sells taxed, undyed kerosene from a blocked pump. The temporary regulations define a blocked pump as a retail fuel pump at a fixed location that is used to dispense undyed kerosene for use by the buyer in a nontaxable use and cannot be used to dispense kerosene directly into the fuel supply tank of a diesel-powered highway vehicle or train (because, for example, of its distance from a road surface or train track or the length of its delivery hose). In addition, blocked pumps must display a prescribed notice.

Treasury and the IRS received many comments relating to the definition of blocked pump. Several commentators noted that many kerosene pumps are on an island next to gasoline pumps so that vehicular access cannot be restricted. Requiring blocked pumps to be on a separate island would not be practical because many service stations do not have the physical space for such an arrangement. Shortening the delivery hose on these pumps would not be practical because doing so would prevent a container from resting on the ground while it is being filled, as safety rules require.

Several commentators suggested expanding the definition to include pumps that are activated by an on-site attendant before each use and are within the direct line of sight of the attendant authorizing the sale to the customer. Other commentators noted that many people who use kerosene for heating purposes do not buy it from a retail pump. So that these customers could obtain undyed kerosene at a tax-excluded price, these commentators suggested that a credit or refund should be allowed to registered ultimate vendors that make home deliveries of undyed kerosene for heating purposes and that sell kerosene in small containers.

Under the final regulations, a blocked pump is a pump that, because of the pump's physical limitations (for example, a short hose), cannot be used to fuel a vehicle, or a pump that is locked by the vendor after each sale and unlocked by the vendor in response to a request by a buyer for undyed kerosene for use other than as a fuel in a diesel-powered highway vehicle or train. As a condition to making a claim with regard to kerosene sold from this latter type of blocked pump, the vendor must obtain the name and address of anyone who buys more than five gallons of kerosene in a single sale. A vendor's registration may be revoked if it allows anyone to fuel a highway vehicle from a blocked pump.

There is no authority in the Internal Revenue Code (Code) to allow ultimate vendor refunds for kerosene solely because the kerosene is delivered to homes for heating purposes or is sold in small containers. Thus, the final regulations do not contain such a provision.

Claims Relating to Sales of Kerosene for Blending During Periods of Extreme Cold. The 1997 Act provides that, to the extent provided in regulations, a credit or refund is allowed to a registered ultimate vendor that sells kerosene for blending with heating oil to be used during periods of extreme or unseasonable cold. The temporary regulations do not provide rules for this provision.

A commentator suggested that the final regulations should implement this provision and define the phrase "period of extreme or unseasonable cold" as including "all the days in November through February."

Under the final regulations, if the IRS declares an area to be affected by extremely cold weather conditions, a credit or refund generally will be allowed to a registered ultimate vendor that sells undyed kerosene for blending with diesel fuel in that affected area if the blended fuel is to be used for heating purposes. It is expected that the periods during which any declaration of extreme cold issued under this provision will be in effect will be limited.

Registration of Heavy Vehicle Manufacturers and Retailers. The tax on the sale of heavy vehicles imposed by section 4051 applies to the first retail sale by the manufacturer, importer, or retailer of a vehicle. The tax is not imposed if a vehicle is sold for resale or for leasing on a long-term basis. Under regulations issued in 1988, this tax-free treatment applied only if both the seller and the buyer were registered by the IRS. The 1997 Act provides, however, that the Secretary shall prescribe regulations so that sales between unregistered parties may be made tax-free if the buyer states under penalties of perjury that the vehicle will be resold. This provision of the 1997 Act is effective January 1, 1998. The temporary regulations implementing the provision are effective on July 1, 1998, the publication date of the temporary regulations.

Several commentators suggested that the final regulations should be effective on January 1, 1998, because the commentators believe that the 1997 Act eliminated the registration requirement as of that date.

The IRS and Treasury are concerned that the suggested change might disqualify sales that would have been tax free under the 1988 regulations. Accordingly, the final regulations retain the July 1, 1998, effective date. They provide, however, that sales (including sales between unregistered parties) that occurred after December 31, 1997, and before July 1, 1998, and otherwise satisfy the requirements of the final regulations may be

made tax free.

Measurement of Taxable Fuel. Existing regulations provide that gallons of taxable fuel may be measured on the basis of actual volumetric gallons, gallons adjusted to 60 degrees Fahrenheit, or any other temperature adjustment method approved by the Commissioner.

The March 14, 1996, proposed regulations proposed to modify this rule so that taxable fuel would be measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit, whichever is the basis for measurement under the position holder's terminaling agreement with the terminal operator. A commentator suggested that measurement at a particular terminal should be applied consistently on an annual basis.

Under the final regulations, annual consistency is required, on a terminal-by-terminal basis, within each one year period beginning on July 1. Thus, a position holder may use only one of the above described bases of measurement with respect to all taxable fuel removed from any particular terminal during each one year period.

Highway Use Tax. Section 4481 imposes a tax on the use of certain highway vehicles. A State to which an application is made to register a highway vehicle generally must receive from the applicant proof of payment of this tax. Proof of payment consists of a receipted Schedule 1 of Form 2290, "Heavy Highway Vehicle Use Tax Return," that is returned to the taxpayer by the IRS after the taxpayer has paid tax on the vehicle. In most cases, the Schedule 1 must include the vehicle identification number (VIN) of each vehicle for which the taxpayer is reporting tax. However, existing regulations provide that a taxpayer reporting tax on more than 21 vehicles need not list the VIN of any vehicle.

Effective July 1, 2000, the final regulations remove this provision. In addition, the instructions for Form 2290 will be changed to require the listing of the VIN of each vehicle reported. The final regulations also remove several obsolete provisions relating to the highway use tax.

Information Reporting. Section 4101(d) allows the IRS to require information reporting by (1) any person registered under section 4101 and (2) such other persons as the IRS deems necessary to administer the taxes on taxable fuel and aviation fuel.

The IRS is developing an information reporting program (Excise Summary Terminal Activity Reporting System (ExSTARS)) for terminal operators and pipeline and vessel operators. The IRS anticipates that ExSTARS will begin later in 2000.

Under the final regulations, information reports to be required by the IRS under section 4101(d) will cover a one month period and a report will be due by the end of the month following the month to which it relates. As a transitional rule, reports under the new rules relating to any month in 2000 will not be due until February 28, 2001.

Registration of pipeline and vessel operators. Effective April 1, 2001, operators of pipelines and vessels in the bulk transfer/terminal system will be required to be registered by the IRS.

Effect on Other Documents

The following publications are obsolete as of March 31, 2000:

Rev. Rul. 57–259, 1957–1 C.B. 423.
Rev. Rul. 57–499, 1957–2 C.B. 788.
Rev. Rul. 73–292, 1973–2 C.B. 376.
Rev. Rul. 78–218, 1978–1 C.B. 367.
Rev. Rul. 86–62, 1986–1 C.B. 325.
Announcement 99–40, 1999–16 I.R.B. 10.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations.

It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the time required to prepare and submit the exemption certificates described in these regulations (many of which are similar to certificates that are already in use) is minimal and will not have a significant impact on those small entities that choose to provide the certificates. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

Pursuant to section 7805(f) of the Code, the notices of proposed rulemaking preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Frank Boland, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, 26 CFR Chapter I is amended as follows:

PART 40–EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 continues to read in part as follows:

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

§40.6011(a)–1 [Amended]

Par. 2. Section 40.6011(a)–1 is amended as follows:

1. In paragraph (b)(2) introductory text, the language "Effective January 1, 1994, the" is removed and "The" is added in its place.

2. In paragraph (b)(2)(v), the language "and kerosene" is added after "diesel fuel".

PART 41–EXCISE TAX ON USE OF CERTAIN HIGHWAY MOTOR VEHICLES

Par. 3. The authority citation for part 41 continues to read in part as follows:

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

Par. 4. Section 41.0–1 is revised to read as follows:

§41.0–1 Introduction.

The regulations in this part are designated "Highway Use Tax Regulations." The regulations in this part relate to the tax on the use of certain highway vehicles imposed by section 4481 and to certain

associated administrative provisions.

§§41.0–2 and 41.0–3 [Removed]

Par. 5. Sections 41.0–2 and 41.0–3 are removed.

Par. 6. Section 41.4481–1 is amended as follows:

1. Paragraphs (a) and (b) are revised.

2. Paragraph (c)(1) introductory text, is amended by removing the language "taxable periods beginning after June 30, 1984," and adding "a taxable period" in its place.

3. Paragraph (c)(3) is amended by revising the introductory text.

4. Paragraph (d)(1) is amended by removing from the last sentence the language "Form 843 (Claim)" and adding "Form 8849 (or such other form as the Commissioner may designate)" in its place.

5. Paragraph (e) introductory text, is amended by adding the language "section 4481 and" after "The application of".

The revisions read as follows:

§41.4481–1 Imposition of tax.

(a) *In general.* Tax is imposed on the use during a taxable period of any registered highway motor vehicle that (together with the semitrailers and trailers customarily used in connection with highway motor vehicles of the same type as such highway motor vehicle) has a taxable gross weight of at least 55,000 pounds.

(b) *Rate of tax.* For the rate of tax generally, see section 4481(a). For the rate of tax for certain vehicles used in logging, see section 4483(e). For the rate of tax for certain vehicles base-plated in Canada or Mexico, see section 4483(f). For a special rule for the taxable period in which the tax terminates, see section 4482(d).

(c) * * *

(3) If the taxable gross weight of a vehicle increases during the month in which the vehicle is first used in a taxable period, the tax for the vehicle for the taxable period is computed on the basis of the increased weight. If the taxable gross weight of a vehicle increases after the month in which the vehicle was first used in a taxable period, the additional tax liability, if any, that results from the increased weight is calculated according to the following formula:

* * * * *

§41.4481–1T [Removed]

Par. 7. Section 41.4481–1T is removed.

Par. 8. In §41.4481–2, paragraph (a)(1) is revised to read as follows:

§41.4481–2 Persons liable for tax.

(a) * * * (1)(i) A person is liable for the tax imposed by section 4481 with respect to the use of a highway motor vehicle in a taxable period if the vehicle is registered in the person's name—

(A) At the time of the first use of the vehicle in the taxable period;

(B) In the case of a vehicle under a suspension of tax described in §41.4483–3(a), at the time the use on the public highways during the taxable period exceeds 5,000 miles (7,500 miles for agricultural vehicles);

(C) At the time that an increase in the taxable gross weight of the vehicle results in an additional tax liability (as computed under §41.4481–1(c)(3)) if the increase occurs after the month in which the vehicle was first used in the taxable period; or

(D) At the time of any use during the taxable period that is after the first use during the period, but only to the extent that the tax or any installment payment of the tax has not previously been paid.

(ii) In any case in which more than one person is liable for the tax for a taxable period, the liability of all persons is satisfied to the extent that the tax is paid by any person liable for the tax.

* * * * *

§41.4482(a)–1 [Amended]

Par. 9. Section 41.4482(a)–1 is amended as follows:

1. Paragraph (a)(2) is amended by removing the language "paragraph (c) of this section" and adding "§48.4061(a)–1(d) of this chapter" in its place.

2. Paragraph (c) is removed.

Par. 10. Section 41.4482(b)–1 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraphs (b), (c), and (d) are removed.

3. Paragraph (e) is redesignated as paragraph (b) and amended as follows:

a. The heading is revised.

b. In newly designated paragraph (b)(1), the first sentence is revised and the second sentence is removed.

c. In newly designated paragraph (b)(2), the language "paragraph (a)" is removed and "paragraph (b)(1)" is added in its place.

4. Paragraph (f) is redesignated as paragraph (c).

5. The undesignated authority citation at the end of the section is removed.

The revisions read as follows:

§41.4482(b)–1 Definition of taxable gross weight.

(a) *Actual unloaded weight*—(1) *In general. Actual unloaded weight* means the empty (or tare) weight of the truck, truck-tractor, or bus, fully equipped for service.

(2) *Trucks and truck-tractors.* A truck or truck-tractor fully equipped for service includes the body (whether or not designed and adapted primarily for transporting cargo, as for example, concrete mixers); all accessories; all equipment attached to or carried on such truck or truck-tractor for use in connection with the movement of the vehicle by means of its own motor or for use in the maintenance of the vehicle; and a full complement of lubricants, fuel, and water. It does not include the driver, any equipment (not including the body) attached to or carried on the vehicle for use in handling, protecting, or preserving cargo, or any special equipment (such as an air compressor, crane, specialized oilfield machinery, etc.) mounted on the vehicle for use on construction jobs, in oilfield operations, etc.

(3) *Buses.* A bus fully equipped for service includes the body; all accessories; all equipment attached to or carried on such bus for use in connection with the movement of the vehicle by means of its own motor, for use in the maintenance of the vehicle, or for the accommodation of passengers or others (such as air conditioning equipment and sanitation facilities, etc.); and a full complement of lubricants, fuel, and water. It does not include the driver.

(b) *Determination of taxable gross weight*—(1) *In general.* The taxable gross weight of a highway motor vehicle is the sum of the actual unloaded weight of the vehicle fully equipped for service, the actual unloaded weight of any semitrailers or trailers fully equipped for service customarily used in combination with the vehicle, and the weight of the maximum load customarily carried on the vehicle and on any semitrailers or trailers customarily used in combination with the vehicle. * * *

* * * * *

§41.4482(b)–1T [Removed]

Par. 11. Section 41.4482(b)–1T is removed.

Par. 12. Section 41.4482(c)–1 is amended as follows:

1. The section heading is revised.

2. Paragraphs (a), (b), and (d) are revised.

The revisions read as follows:

§41.4482(c)–1 Definition of State, taxable period, use, and customarily used.

(a) *State*. *State* includes any State, any political subdivision of a State, the District of Columbia, and, to the extent provided by section 7871, any Indian tribal government.

(b) *Taxable period*. For the definition of *taxable period*, see section 4482(c).

* * * * *

(d) *Customarily used*. A semitrailer or trailer is treated as *customarily used* in connection with a highway motor vehicle if the vehicle is equipped to tow the semitrailer or trailer.

Par. 13. Section 41.4483–1 is revised to read as follows:

§41.4483–1 State exemption.

Use of a highway motor vehicle by a State is exempt from the tax imposed by section 4481. For this purpose, the term *use by a State* means the operation by a State on the public highways in the United States of any highway motor vehicle, whether or not such highway motor vehicle is owned by the State.

Par. 14. Section 41.4483–2 is amended as follows:

1. Paragraph (a) is amended by removing the language "section 6421(b)(2), as set forth in".

2. Paragraph (e) is amended as follows:

a. Paragraph (e) introductory text, is amended by removing the language "set forth in section 6421(b)(2)".

b. Paragraph (e)(1) is amended by removing the language "(rather than any different period prescribed in section 6421(b)(2))".

c. Paragraph (e)(2), first sentence, is amended by removing the language "(see section 4263(a))".

d. Paragraph (e)(2), last sentence, is revised.

3. Paragraph (f) *Example (1)*, penultimate sentence, is amended by removing the language "(not including any tax on the transportation of persons imposed by section 4261)".

The revision reads as follows:

§41.4483–2 Exemption for certain transit-type buses.

* * * * *

(e) * * *

(2) * * * In determining the total of such passenger fare revenue, revenue from sources such as charter fees, rentals of property, advertising receipts, etc., is not taken into account.

* * * * *

§41.4483–3 [Amended]

Par. 15. Section 41.4483–3 is amended as follows:

1. Paragraph (a)(2) is amended by removing the language "(Federal Heavy Vehicle Use Tax Return)".

2. Paragraph (b) is amended as follows:

a. The first sentence is amended by removing the language "shall pay" and adding "is liable for" in its place.

b. The last two sentences are removed.

3. Paragraph (f) is amended as follows:

a. The second sentence is removed.

b. The last sentence is amended by adding the language "and §41.6011(a)–1(a)(3) for a requirement that certain transferees described in this paragraph (f) must file a return" after "suspension from tax".

§41.4483–5 [Removed]

Par. 16. Section 41.4483–5 is removed.

§41.4484–1 [Removed]

Par. 17. Section 41.4484–1 is removed.

§41.6001–1 [Amended]

Par. 18. Section 41.6001–1 is amended as follows:

1. Paragraph (a)(6) is amended by removing the language "for taxable periods after June 30, 1984".

2. Paragraph (a)(7) is amended as follows:

a. The first sentence is amended by removing the language "or, for taxable periods after June 30, 1984," and adding "or" in its place.

b. The last sentence is removed.

3. Paragraph (b) is amended by removing the language "whether he meets" and adding "whether it meets" in its place.

§41.6001–2 [Amended]

Par. 19. Section 41.6001–2 is amended as follows:

1. Paragraph (a), second sentence, is amended by removing the language "104(b)(5)" and adding "104(b)(4)" in its place.

2. Paragraph (c)(1)(ii) introductory text, is amended by removing the language "If a receipted" and adding "With respect to taxable periods beginning before July 1, 2000, if a receipted" in its place.

3. Paragraph (c)(1)(iii), first sentence, is amended by removing the language "If a Schedule 1" and adding "With respect to taxable periods beginning before July 1, 2000, if a Schedule 1" in its place.

4. Paragraph (d) is amended as follows:

a. *Example (1)*, seventh sentence, is amended by removing the language "§41.4482(b)–1(e)" and adding "§41.4482(b)–1" in its place.

5. *Example (2)*, second sentence, is amended by removing the language "§41.4482(b)–1(e)" and adding "§41.4482(b)–1" in its place.

6. *Example (4)* is removed.

Par. 20. Section 41.6011(a)–1 is revised to read as follows:

§41.6011(a)–1 Returns.

(a) *In general*. (1) A person that is liable for tax under §41.4481–2(a)(1)(i)(A), (B), or (C) must file a return for the taxable period with respect to the tax imposed by section 4481.

(2) A person that is liable for tax under §41.4481–2(a)(1)(i)(D) must file a return for a taxable period with respect to the tax imposed by section 4481 if the Commissioner notifies the person that the tax for the taxable period has not been paid in full.

(3) A transferee of a vehicle that receives a statement described in the first sentence of §41.4483–3(f) must file a return with the statement attached.

(b) *Form 2290*. The return required under paragraph (a) of this section is Form 2290, "Heavy Highway Vehicle Use Tax Return," or such other return as the Commissioner may prescribe. The return is made in accordance with the instructions applicable to the form.

Par. 21. Section 41.6071(a)–1 is amended as follows:

1. Paragraph (a) is revised.

2. Paragraph (b) is removed.

3. Paragraph (c) is redesignated as paragraph (b).

4. Newly designated paragraph (b) is amended by removing the language "(but in no event earlier than the time prescribed in paragraph (a)(1) of this section for filing a return)".

5. Paragraphs (d), (e), and (f) are removed.

The revision reads as follows.

§41.6071(a)–1 Time for filing returns.

(a) *In general*. Except as provided in paragraph (b) of this section, a return described in §41.6011(a)–1 must be filed by the last day of the month following the month in which—

(1) A person becomes liable for tax under §41.4481–2(a)(1)(i)(A), (B), or (C);

(2) A person that is liable for tax under §41.4481–2(a)(1)(i)(D) is notified by the Commissioner that the tax has not been paid in full; or

(3) A transferee described in §41.4483–3(f) acquires the vehicle.

* * * * *

§41.6081(a)–1 [Removed]

Par. 22. Section 41.6081(a)–1 is removed.

Par. 23. Section 41.6091–1 is revised to read as follows:

§41.6091–1 Place for filing returns.

(a) *In general*. Except as provided in paragraph (b) of this section, returns must be filed in accordance with the instructions applicable to the form on which the return is made.

(b) *Hand-carried returns*—(1) *Persons other than corporations*. Returns of persons other than corporations that are filed by hand carrying must be filed with the Commissioner in the internal revenue district in which is located the principal place of business or legal residence of the person.

(2) *Corporations*. Returns of corporations that are filed by hand carrying must be filed with the Commissioner in the internal revenue district in which is located the principal place of business or principal office or agency of the corporation.

Par. 24. Section 41.6101–1 is revised to read as follows:

§41.6101–1 Period covered by returns.

Each return is for a taxable period as defined in section 4482.

Par. 25. Section 41.6109–1 is revised to read as follows:

§41.6109–1 Identifying numbers.

Every person required under §41.6011(a)–1 to make a return must provide the identifying number required by the instructions to the form on which the return is made.

Par. 26. Section 41.6151(a)–1 is revised to read as follows:

§41.6151(a)–1 Time and place for paying tax.

The tax must be paid at the time prescribed in §41.6071(a)–1 for filing the return and at the place prescribed in §41.6091–1 for filing the return.

§§41.6161(a)(1)–1, 41.6302(b)–1, and 41.7805–1 [Removed]

Par. 27. Sections 41.6161(a)(1)–1, 41.6302(b)–1, and 41.7805–1 are removed.

PART 47— [REMOVED]

Par. 28. Part 47 is removed.

PART 48–MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 29. The authority citation for part 48 is amended by removing the entries for sections 48.4081–7 and 48.4081–9(e); 48.4082–6T, 48.4082–7T, and 4082–8T; 48.4101–2; 48.4101–3T; 48.6427–8; 48.6427–9; and 48.6427–10T and 48.6427–11T and adding entries in numerical order to read in part as follows:

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

Section 48.4052–1 also issued under 26 U.S.C. 4052(g). * * *

Section 48.4081–7 also issued under 26 U.S.C. 4081(e). * * *

Section 48.4082–6 also issued under 26 U.S.C. 4082(d).

Section 48.4082–7 also issued under 26 U.S.C. 4082(d). * * *

Section 48.4101–2 also issued under 26 U.S.C. 6071(a). * * *

Section 48.6427–8 also issued under 26 U.S.C. 6427(m).

Section 48.6427–9 also issued under 26 U.S.C. 6427(m).

Section 48.6427–10 also issued under 26 U.S.C. 6427(m).

Section 48.6427–11 also issued under 26 U.S.C. 6427(m).

Par. 30. The undesignated editorial note and its authority citation at the end of the authority citation are removed.

§48.0–2 [Amended]

Par. 31 In §48.0–2, paragraph (a)(2) is removed and reserved.

§48.4041–21 [Amended]

Par. 32. Section 48.4041–21, paragraph (c)(1), first sentence, is amended by removing the language "§48.4082–4(c)(1) through (c)(4)(i) or (c)(5) through (c)(10)." and adding "section 4041(a)(3)(B), (b)(1), (f), (g), or (h)." in its place.

Par. 33. In Subpart H, §48.4052–1 is added under the undesignated center heading "Motor Vehicles" to read as follows:

§48.4052–1 Heavy trucks and trailers; certification requirement.

(a) *In general*. Tax is not imposed by section 4051 on the sale of an article for resale or leasing in a long-term lease if, by the time of sale, the seller has in good faith accepted from the buyer a statement that the buyer executed in good faith and that is in substantially the same form, and subject to the same conditions, as the certificate described in §145.4052–1(a)(6) of this chapter, except that the certificate must be signed under penalties of perjury and need not refer to Form 637 or include a registration number.

(b) *References to §145.4052–1(a)(2) of this chapter*. References to §145.4052–1(a)(2) of this chapter appearing in §145.4052–1 of this chapter apply also to paragraph (a) of this section.

(c) *Effective date*. This section is applicable after June 30, 1998. In addition, tax is not imposed on a sale occurring after December 31, 1997, and before July 1, 1998, if the conditions of paragraph (a) of this section are satisfied.

Par. 34. Section 48.4081–1 is amended as follows:

1. Paragraph (b) is amended by:

a. Revising the definition of Aviation gasoline.

b. Removing the definition of Diesel-powered boat.

c. Adding the definition of Excluded liquid in alphabetical order.

d. Adding the definition of Kerosene in alphabetical order.

e. Revising the definition of Rack.

f. Removing the language "(as defined in §48.4041–8(f))" in the definition of Removal, first sentence.

g. Removing the language "subject to the limitations of section 7871, any Indian

tribal government." and adding "to the extent provided by section 7871, any Indian tribal government." in its place in the definition of State.

h. Revising the definition of Taxable fuel.

i. Adding the language "as such" after "is registered" in the definition of Taxable fuel registrant.

j. Removing the language "operated by a taxable fuel registrant if all of the finished gasoline and diesel fuel (other than diesel fuel dyed in accordance with §48.4082–1(b))" and adding "where finished gasoline, undyed diesel fuel, or undyed kerosene is stored if the facility is operated by a taxable fuel registrant and all such taxable fuel" in its place in the definition of Terminal, last sentence.

2. Paragraph (c)(1)(i) introductory text, is amended by removing the language "and (c)(iii)" and adding "and (c)(1)(iii)" in its place.

3. Paragraph (c)(1)(i)(A) is amended by adding the language "(other than taxable fuel for which a credit or payment has been allowed)" after "4081(a)".

4. Paragraphs (c)(2) and (d) are revised.

5. Paragraphs (e) and (f) are added.

The revisions and additions read as follows:

§48.4081–1 Taxable fuel; definitions.

* * * * *

(b) * * *

Aviation gasoline means all special grades of gasoline that are suitable for use in aviation reciprocating engines and covered by ASTM specification D 910 or military specification MIL-G-5572. For availability of ASTM and military specifications, see paragraph (d) of this section.

* * * * *

Excluded liquid means any liquid that—

(1) Contains less than four percent normal paraffins; or

(2) Has a—

(i) Distillation range of 125% F. or less;

(ii) Sulfur content of 10 ppm or less; and

(iii) Minimum color of +27 Saybolt.

* * * * *

Kerosene means any liquid that meets the specifications for kerosene or would meet those specifications but for the presence in the liquid of a dye of the type described in §48.4082–1(b). A liquid meets the specifications for kerosene if it is one of the two grades of kerosene (No. 1-K and No. 2-K) covered by ASTM specification D 3699, or kerosene-type jet fuel covered by ASTM specification D 1655 or military specification MIL-DTL-5624T (Grade JP-5) or MIL-DTL-83133E (Grade JP-8). For availability of ASTM and military specifications, see paragraph (d) of this section. However, the term does not include *excluded liquid*.

* * * * *

Rack means a mechanism capable of delivering taxable fuel into a means of transport other than a pipeline or vessel.

* * * * *

Taxable fuel means gasoline, diesel fuel, and kerosene.

* * * * *

(c) * * *

(2) *Diesel fuel*—(i) *In general*. Except as provided in paragraph (c)(2)(ii) of this section, *diesel fuel* means any liquid that, without further processing or blending, is suitable for use as a fuel in a diesel-powered highway vehicle or diesel-powered train.

(ii) *Exclusion*. *Diesel fuel* does not include gasoline, kerosene, excluded liquid, No. 5 and No. 6 fuel oils covered by ASTM specification D 396, or F-76 (Fuel Naval Distillate) covered by military specification MIL-F-16884. For availability of ASTM and military specifications, see paragraph (d) of this section.

* * * * *

(d) *ASTM and military specifications*. ASTM specifications may be obtained from the American Society for Testing and Materials, 100 Barr Harbor Drive, West Conshohocken, PA 19428. Military specifications may be obtained from the Standardization Document Order Desk, Building 4, Section D, 700 Robbins Avenue, Philadelphia, PA 19111.

(e) *Other definitions*. For other definitions relating to taxable fuel, see §§48.4081–6(b), 48.4082–5(b), 48.4082–6(b), 48.4082–7(b), 48.4101–1(b), 48.6427–9(b), 48.6427–10(b), and 48.6427–11(b).

(f) *Effective date*. (1) Except as provided in paragraph (f)(2) of this section, this section is applicable after December 31, 1993.

(2) In paragraph (b) of this section, the definition of aviation gasoline and the third sentence in the definition of terminal are applicable after January 1, 1998, and the definitions of kerosene, excluded liquid, and taxable fuel are applicable after June 30, 1998. Paragraph (c)(2) of this section is applicable after December 31, 1997.

§48.4081–1T [Removed]

Par. 35. Section 48.4081-1T is removed.

Par. 36. Section 48.4081-2 is amended as follows:

1. Paragraph (b) is amended by removing the language "Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), tax" and adding "Tax" in its place.

2. Paragraph (c)(3) is amended by adding the language "or kerosene" after "diesel fuel" each place it appears.

3. Paragraph (e) is revised.

4. Paragraph (f) is added.

The addition and revision read as follows:

§48.4081-2 Taxable fuel; tax on removal at a terminal rack.

* * * * *

(e) *Exemptions*. For exemptions from the tax imposed under this section, see §§48.4081-4 (relating to gasoline blendstocks), 48.4082-1 (relating to dyed diesel fuel and dyed kerosene), 48.4082-5 (relating to diesel fuel and kerosene used in Alaska), 48.4082-6 (relating to aviation-grade kerosene), and 48.4082-7 (relating to kerosene used for a feedstock purpose).

(f) *Effective date*. This section is applicable after December 31, 1993.

Par. 37. Section 48.4081-3 is amended as follows:

1. Paragraph (a) is amended by removing the last sentence.

2. Paragraph (b)(1) is amended as follows:

a. In the introductory text, the language "Except as provided in paragraph (b)(2) of this section (relating to an exemption for certain refineries), §48.4081-4 (relating to gasoline blendstocks), and §48.4082-1 (relating to dyed diesel fuel), tax" is removed and "Tax" is added in its place.

b. In paragraph (b)(1)(i), the language "of taxable fuel" is added after "A removal".

c. In paragraph (b)(1)(ii), the language "of taxable fuel" is added after "A re-

moval".

d. In paragraph (b)(1)(iii), third sentence, the language "§40.6302(c)-1(e)(4)" is removed and "§40.6302(c)-1(f)(4)" is added in its place.

3. In paragraph (c)(1) introductory text, the language "Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), a tax" is removed and "Tax" is added in its place.

4. In paragraph (d)(1), the language "A tax is imposed" is removed and "Tax is imposed" is added in its place.

5. In paragraph (e)(1) introductory text, the language "Except as provided in §48.4081-4 (relating to gasoline blendstocks) and §48.4082-1 (relating to dyed diesel fuel), a tax" is removed and "Tax" is added in its place.

6. In paragraph (f)(1), the language "Except as provided in paragraph (f)(2) of this section and §48.4082-1 (relating to dyed diesel fuel), a tax" is removed and "Tax" is added in its place.

7. Paragraph (i) is revised.

8. Paragraph (j) is added.

The revision and addition read as follows:

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

* * * * *

(i) *Exemptions*. For exemptions from the taxes imposed under this section, see §§48.4081-4 (relating to gasoline blendstocks), 48.4082-1 (relating to dyed diesel fuel and dyed kerosene), 48.4082–5 (relating to diesel fuel and kerosene used in Alaska), 48.4082-6 (relating to aviation-grade kerosene), and 48.4082–7 (relating to kerosene used for a feedstock purpose).

(j) *Effective date*. This section is applicable January 1, 1994.

Par. 38. In §48.4081–6, paragraph (b)(3) is revised to read as follows:

§48.4081–6 Gasoline; gasohol.

* * * * *

(b) * * *

(3) *Gasohol blender*. Gasohol blender means any person that regularly produces gasohol outside of the bulk transfer/terminal system for sale or use in its trade or business.

* * * * *

§48.4081–7 [Amended]

Par. 39. Section 48.4081–7 is amended as follows:

1. In paragraph (c)(2), First Taxpayer's Report, the following language is removed:

"7._____
Location of IRS service center where this report is filed"

2. In paragraph (c)(4)(v), the language "gasoline" is removed each place it appears and "taxable fuel" is added in its place.

3. In paragraph (f) *Example 1*, the language "gasoline registrant" is removed and "taxable fuel registrant" is added in its place in the following locations:

a. Paragraph (i), first sentence.

b. Paragraph (i), second sentence.

c. Paragraph (ii), first sentence.

Par. 40. In §48.4081–8, paragraph (a) is revised to read as follows:

§48.4081–8 Taxable fuel; measurement.

(a) *In general*. Volumes of taxable fuel may be measured on the basis of actual volumetric gallons or gallons adjusted to 60 degrees Fahrenheit. However, beginning July 1, 2000, for each period from July 1 through the following June 30—

(1) A person liable for the tax on removal may use only one of the two bases of measurement with respect to all taxable fuel removed during the period from any particular terminal, refinery, or blending facility;

(2) A person liable for the tax on entry may use only one of the two bases of measurement with respect to all taxable fuel entered into the United States during the period at any particular point of entry; and

(3) A person liable for the tax on sale may use only one of the two bases of measurement with respect to all taxable fuel sold during the period to any particular buyer.

* * * * *

§48.4081–9 [Removed]

Par. 41. Section 48.4081–9 is removed.

Par. 42. Section 48.4082–1 is amended as follows:

1. The section heading is revised.

2. In paragraph (a) introductory text, the language "or kerosene" is added after "diesel fuel".

3. In paragraph (a)(3), the language "or kerosene" is added after "diesel fuel".

4. In paragraph (b), the introductory text is revised.

5. In paragraph (b)(1), the language "or kerosene" is added after "diesel fuel".

The revisions read as follows:

§48.4082–1 Diesel fuel and kerosene; exemption for dyed fuel.

* * * * *

(b) * * * Diesel fuel or kerosene satisfies the dyeing requirement of this paragraph (b) only if the diesel fuel or kerosene contains—

* * * * *

Par. 43. Sections 48.4082–2 and 48.4082–3 are revised to read as follows:

§48.4082–2 Diesel fuel and kerosene; notice required for dyed fuel.

(a) *In general*. A legible and conspicuous notice stating "*DYED DIESEL FUEL, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE*" must be posted by a seller on any retail pump or other delivery facility where it sells dyed diesel fuel for use by its buyer. A legible and conspicuous notice stating "*DYED KEROSENE, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE*" must be posted by a seller on any retail pump or other delivery facility where it sells dyed kerosene for use by its buyer. Any seller that fails to post the required notice on any retail pump or other delivery facility where it sells dyed fuel is, for purposes of the penalty imposed by section 6715, presumed to know that the fuel will not be used for a nontaxable use.

(b) *Cross reference; terminal operators*. For the requirement that terminal operators provide a notice with respect to dyed fuel, see §48.4101–1(h)(3) (relating to terms and conditions of registration for terminal operators).

(c) *Effective date*. This section is applicable with respect to diesel fuel after December 31, 1993, and with respect to kerosene after June 30, 1998.

§48.4082–3 Diesel fuel and kerosene; visual inspection devices. [Reserved]

Par. 44. Section 48.4082–4 is amended as follows:

1. The section heading is revised.

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

3. Paragraph (a)(2)(i) is amended by removing the language "or boat".

4. Paragraphs (b) heading and (b)(1) are revised.

5. Paragraph (c) is amended by:

a. Removing paragraphs (c)(4) and (c)(10);

b. Redesignating paragraphs (c)(5), (c)(6), (c)(7), (c)(8), and (c)(9) as para-

graphs (c)(4), (c)(5), (c)(6), (c)(7), and (c)(8), respectively.

c. Adding the language "or" at the end of newly designated paragraph (c)(7).

d. Removing the language "highway; or" at the end of newly designated paragraph (c)(8) and adding "highway." in its place.

6. Paragraph (d) is revised.

The revisions read as follows:

§48.4082–4 Diesel fuel and kerosene; back-up tax.

(a) *Imposition of tax*—(1) *In general*. Tax is imposed by section 4041 on the delivery into the fuel supply tank of the propulsion engine of a diesel-powered highway vehicle (other than a diesel-powered bus) of—

(i) Any diesel fuel or kerosene on which tax has not been imposed by section 4081;

(ii) Any diesel fuel or kerosene for which a credit or payment has been allowed under section 6427; or

(iii) Any liquid (other than taxable fuel) for use as fuel.

* * * * *

(b) *Tax on diesel fuel and kerosene; buses and trains*—(1) *In general*. Tax is imposed by section 4041 on the delivery into the fuel supply tank of the propulsion engine of a diesel-powered bus or a diesel-powered train of—

(i) Any diesel fuel or kerosene on which tax has not been imposed by section 4081;

(ii) Any diesel fuel or kerosene for which a credit or payment has been allowed under section 6427; or

(iii) Any liquid (other than taxable fuel) for use as fuel.

* * * * *

(d) *Effective date*. This section is applicable after December 31, 1993, except that references to kerosene are applicable after June 30, 1998.

Par. 45. Section 48.4082–5 is amended as follows:

1. The section heading is revised.

2. Paragraph (a) is amended by adding "or kerosene" after "diesel fuel".

3. Paragraph (b), definition of Exempt area of Alaska, is amended by removing the language "Clear" and adding "Clean" in its place.

4. Paragraphs (b), (c), (d), and (g) are amended by adding "or kerosene" after "diesel fuel" in the following locations:

a. Paragraph (b), definition of Qualified dealer, paragraph (1).

b. Paragraph (c) introductory text.

c. Paragraph (c)(3).

d. Paragraph (d)(1) introductory text.

e. Paragraph (d)(2).

f. Paragraph (g).

5. Paragraph (h), first sentence, is revised.

The revisions read as follows:

§48.4082–5 Diesel fuel and kerosene; Alaska.

* * * * *

(h) *Effective date.* This section is applicable with respect to diesel fuel removed or entered after December 31, 1996, and with respect to kerosene removed or entered after June 30, 1998. * * *

Par. 46. Sections 48.4082–6 and 48.4082–7 are added to read as follows:

§48.4082–6 Kerosene; exemption for aviation-grade kerosene.

(a) *Overview.* This section prescribes the conditions under which tax does not apply to the removal or entry of aviation-grade kerosene that is destined for use as a fuel in an aircraft.

(b) *Definition*. For purposes of this section, *aviation-grade kerosene* means kerosene-type jet fuel covered by ASTM specification D 1655 or military specification MIL-DTL-5624T (Grade JP-5) or MIL-DTL-83133E (Grade JP-8). For availability of ASTM and military specifications, see §48.4081–1(d).

(c) *Exemption for certain removals and entries*. Tax is not imposed under §48.4081–2(b), 48.4081–3(b)(1)(ii), or 48.4081–3(c)(1)(ii) on the removal or entry of aviation-grade kerosene if—

(1) The person otherwise liable for tax is a taxable fuel registrant;

(2) In the case of a removal from a terminal, the terminal is an approved terminal; and

(3)(i) The person otherwise liable for tax delivers the kerosene into the fuel supply tank of an aircraft and this delivery is not in connection with a sale; or

(ii) The kerosene is sold for use as a fuel in an aircraft and, at the time of the sale, the person otherwise liable for tax has an unexpired certificate (described in paragraph (e) of this section) from the buyer and has no reason to believe any information in the certificate is false.

(d) *Certain later sales*—(1) *In general*. Paragraph (c) of this section does not apply with respect to kerosene that is sold as described in paragraph (c)(3)(ii) of this section if there is a later disqualifying sale of the kerosene. A later disqualifying sale is any later sale other than a later sale—

(i) By a person that, at the time of the sale, has an unexpired certificate (described in paragraph (e) of this section) from the buyer and has no reason to believe that any information in the certificate is false; or

(ii) In connection with the delivery of the kerosene into the fuel supply tank of an aircraft.

(2) *Imposition of tax; liability for tax.* Notwithstanding §§48.4081–2 and 48.4081–3, in any case in which paragraph (d)(1) of this section applies, tax is imposed with respect to that kerosene at the time of the first later disqualifying sale and the seller in that sale is liable for the tax.

(3) *Rate of tax*. For the rate of tax, see section 4081.

(e) *Certificate*—(1) *In general*. The certificate described in this paragraph (e) is a statement by a buyer that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate provided in paragraph (e)(3) of this section, and contains all information necessary to complete the model certificate. A new certificate or notice that the current certificate is invalid must be given if any information in the current certificate changes. The certificate may be included as part of any business records normally used to document a sale. The certificate expires on the earliest of the following dates:

(i) The date one year after the effective date of the certificate (which may be no earlier than the date it is signed).

(ii) The date the buyer provides the seller a new certificate or notice that the current certificate is invalid.

(iii) The date the Internal Revenue Service or the buyer notifies the seller that the buyer's right to provide a certificate has been withdrawn.

(2) *Withdrawal of the right to provide a certificate*. The Internal Revenue Service may withdraw the right of a buyer of aviation-grade kerosene to provide a certificate under this section if the buyer uses the aviation–grade kerosene to which a

certificate relates other than as a fuel in an aircraft or sells the kerosene without first obtaining a certificate from its buyer. The Internal Revenue Service may notify any seller to whom the buyer has provided a certificate that the buyer's right to provide a certificate has been withdrawn.

(3) *Model certificate.*

CERTIFICATE OF PERSON BUYING AVIATION-GRADE KEROSENE FOR USE AS A FUEL IN AN AIRCRAFT

(To support tax-free removals and entries of aviation-grade kerosene under section 4082 of the Internal Revenue Code.)

_____ (Buyer) certifies the following under penalties of perjury:

Name of Buyer

The aviation-grade kerosene to which this certificate applies will be used by Buyer as a fuel in an aircraft or resold by Buyer for that use.

This certificate applies to _____ percent of Buyer's purchases from _____ (name, address, and employer identification number of seller) as follows (complete as applicable):

1. A single purchase on invoice or delivery ticket number _____.

2. All purchases between _____ (effective date) and _____ (expiration date) (period not to exceed one year after the effective date) under account or order number(s) _____. If this certificate applies only to Buyer's purchases for certain locations, check here _____ and list the locations.

_____

_____

_____

Buyer is buying the kerosene for (check either or both as applicable):

_____ Buyer's use as a fuel in an aircraft.

_____ Resale for use as a fuel in an aircraft.

Buyer will provide a new certificate to the seller if any information in this certificate changes.

If Buyer sells the aviation-grade kerosene to which this certificate relates and does not deliver it into the fuel supply tank of an aircraft, Buyer will be liable for tax unless Buyer obtains a certificate from its buyer stating that the aviation-grade kerosene will be used as a fuel in an aircraft.

If Buyer violates the terms of this certificate, the Internal Revenue Service may withdraw Buyer's right to provide a certificate.

Buyer has not been notified by the Internal Revenue Service that its right to provide a certificate has been withdrawn.

The fraudulent use of this certificate may subject Buyer and all parties making any fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Employer identification number

_____

Address of Buyer

_____

Signature and date signed

(f) *Effective date*. This section is applicable after March 30, 2000, except that paragraph (d) of this section is applicable after June 30, 2000.

§48.4082–7 Kerosene; exemption for feedstock purposes.

(a) *Overview*. This section prescribes the conditions under which tax does not apply to the removal or entry of kerosene for use for a feedstock purpose.

(b) *Definitions*. The following definitions apply to this section:

Feedstock purpose means the use of kerosene for nonfuel purposes in the manufacture or production of any substance other than gasoline, diesel fuel, or special fuels referred to in section 4041. Thus, for example, kerosene is used for a feedstock purpose when it is used as an ingredient in the production of paint and is not used for a feedstock purpose when it is used to power machinery at a factory where paint is produced.

Feedstock user means a person that uses kerosene for a feedstock purpose.

Registered feedstock user means a feedstock user that is—

(1) Registered under section 4101 as a feedstock user; or

(2) With respect to removals and entries before October 1, 2000, a taxable fuel registrant.

(c) *Exemption for removals and entries*. Tax is not imposed on the removal or entry of kerosene if—

(1) The person otherwise liable for tax is a taxable fuel registrant;

(2) In the case of a removal from a terminal, the terminal is an approved terminal; and

(3)(i) The person otherwise liable for tax uses the kerosene for a feedstock purpose; or

(ii) The kerosene is sold for use by the buyer for a feedstock purpose and, at the

time of the sale, the person otherwise liable for tax has an unexpired certificate (described in paragraph (e) of this section) from the buyer and has no reason to believe any information in the certificate is false.

(d) *Later sale*—(1) *In general.* Paragraph (c) of this section does not apply with respect to kerosene that is sold as described in paragraph (c)(3)(ii) of this section if the buyer in that sale (the certifying buyer) sells the kerosene.

(2) *Imposition of tax; liability for tax.* Notwithstanding §§48.4081–2 and 48.4081–3, in any case in which paragraph (d)(1) of this section applies, tax with respect to that kerosene is imposed at the time of the sale by the certifying buyer and the certifying buyer is liable for the tax.

(3) *Rate of tax.* For the rate of tax, see section 4081.

(e) *Certificate*—(1) *In general.* The certificate described in this paragraph (e) is a statement by a buyer that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate provided in paragraph (e)(2) of this section, and contains all information necessary to complete the model certificate. A new certificate or notice that the current certificate is invalid must be given if any information in the current certificate changes. The certificate may be included as part of any business records normally used to document a sale. The certificate expires on the earliest of the following dates:

(i) The date one year after the effective date of the certificate (which may be no earlier than the date it is signed).

(ii) The date the buyer provides the seller a new certificate or notice that the current certificate is invalid.

(iii) The date the seller is notified by the Internal Revenue Service or the buyer that the buyer's registration has been revoked or suspended.

(2) *Model certificate.*

CERTIFICATE OF REGISTERED
FEEDSTOCK USER

(To support tax-free removals and entries of kerosene under section 4082 of the Internal Revenue Code.)

_____ (Buyer) certifies the following under penalties of perjury:

Name of Buyer

Buyer is a registered feedstock user with registration number _____. Buyer's registration has not been revoked or suspended.

The kerosene to which this certificate applies will be used by Buyer for a feedstock purpose.

This certificate applies to _____ percent of Buyer's purchases from _____ (name, address, and employer identification number of seller as follows (complete as applicable):

1. A single purchase on invoice or delivery ticket number _____.

2. All purchases between _____ (effective date) and _____ (expiration date) (period not to exceed one year after the effective date) under account or order number(s) _____. If this certificate applies only to Buyer's purchases for certain locations, check here _____ and list the locations.

_____

_____

_____

If Buyer sells the kerosene to which this certificate relates, Buyer will be liable for tax on that sale.

Buyer will provide a new certificate to the seller if any information in this certificate changes.

If Buyer violates the terms of this certificate, the Internal Revenue Service may revoke Buyer's registration.

Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making any fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Employer identification number

_____

Address of Buyer

_____

Signature and date signed

(f) *Effective date*. This section is applicable after March 30, 2000, except that paragraph (d) of this section is applicable after June 30, 2000.

§§48.4082–6T, 48.4082–7T, 48.4082–8T, 48.4082–9T, and 48.4082–10T [Removed]

Par. 47. Sections 48.4082–6T, 48.4082–7T, 48.4082–8T, 48.4082–9T, and 48.4082–10T are removed.

Par. 48. Section 48.4083–1 is amended as follows:

1. In paragraph (c)(2), first sentence, the language "vehicle, train, or boat" is removed and "vehicle or train" is added in its place.

2. Paragraph (d) is revised.

The revision reads as follows:

§48.4083–1 Taxable fuel; administrative authority.

* * * * *

(d) *Refusal to submit to inspection*. For the penalty for any refusal to permit an entry or inspection authorized by this section, see section 4083(c)(3). This penalty is in addition to any tax that may be imposed by section 4041 or 4081 and any penalty that may be imposed by section 6715.

* * * * *

§48.4091–3T [Redesignated as §48.4091–3] §48.4091–3 [Amended]

Par. 49. Section 48.4091–3T is redesignated as §48.4091–3 and the language "(temporary)" is removed from the section heading.

Par. 50. Section 48.4101–1 is amended as follows:

1. The section heading is revised.

2. Paragraph (a)(1) is amended by removing the language "registered ultimate vendors of diesel fuel" and adding "certain ultimate vendors of diesel fuel and kerosene" in its place.

3. Paragraph (a)(2) is amended by adding a sentence to the end of the paragraph.

4. Paragraph (a)(6) is added.

5. Paragraphs (b)(7), (b)(8), and (b)(9) are added.

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

7. Paragraph (d) is revised.

8. Paragraph (f)(1)(i) heading is revised.

9. Paragraph (f)(1)(ii) heading and introductory text are revised.

10. Paragraph (h)(1)(iii) is amended by removing the language "and §48.4101–2".

11. Paragraph (h)(2)(iii) is revised.

12. Paragraph (h)(2)(iv) is added.

13. Paragraph (h)(3)(i) is revised.

14. Paragraph (h)(3)(ii) is amended by adding "or kerosene" after "diesel fuel" in the heading and the introductory text.

15. Paragraph (h)(3)(v) is amended by adding "or kerosene" after "diesel fuel" each place it appears.

16. Paragraphs (i)(2)(ii) and (i)(2)(iii) are amended by removing the language "vendor" and adding "vendor or an ultimate vendor (blocked pump)" in its place.

17. Paragraph (k) is amended by adding a sentence to the end of the paragraph.

18. Paragraph (l)(2) is amended by adding the language ",except that paragraphs (c)(1)(iii) and (c)(1)(vi) of this section are applicable after March 31, 2001" after "January 1, 1995".

19. Paragraph (l)(4) is added.

The revisions and additions read as follows:

§48.4101–1 Taxable fuel; registration.

(a) * * *

(2) * * * However, the United States is treated as registered under section 4101.

* * * * *

(6)(i) A person is treated as a taxable fuel registrant if on June 30, 1998, the person—

(A) Is an enterer, refiner, terminal operator, or throughputter with respect to kerosene and is registered under section 4101 as a producer or importer of aviation fuel;

(B) Operates one or more terminals that store kerosene (and no other type of taxable fuel); or

(C) Is a commercial airline, an operator of aircraft in noncommercial aviation, or a fixed base operator and is also a position holder with respect to kerosene.

(ii) A person treated as registered under paragraph (a)(6)(i) of this section is treated as registered from July 1, 1998, until the earlier of—

(A) The date of a subsequent denial of an application for registration under paragraph (g)(2) of this section;

(B) The effective date of a subsequent registration issued under paragraph (g)(3) of this section;

(C) The effective date of a subsequent revocation or suspension of registration under paragraph (i) of this section; or

(D) July 1, 1999.

(b) * * *

(7) *Pipeline operator.* A *pipeline operator* is any person that operates a pipeline within the bulk transfer/terminal system.

(8) *Vessel operator*. A *vessel operator* is any person that operates a vessel within the bulk transfer/terminal system. However, for purposes of this definition, *vessel* does not include a deep draft oceangoing vessel (as defined in §48.4042–3(a)).

(9) *Other definitions.* For other definitions relating to taxable fuel, see §§48.4081–1, 48.4081–6(b), 48.4082–5(b), 48.4082–6(b), 48.4082–7(b), 48.6427–9(b), 48.6427–10(b), and 48.6427–11(b).

(c) * * * (1) *In general*. A person is required to be registered under section 4101 if the person is–

(i) A blender;

(ii) An enterer;

(iii) A pipeline operator;

(iv) A position holder;

(v) A terminal operator; or

(vi) A vessel operator.

* * * * *

(d) *Persons that may, but are not required to, be registered*. A person may, but is not required to, be registered under section 4101 if the person is—

(1) A feedstock user;

(2) A gasohol blender;

(3) An industrial user;

(4) A throughputter that is not a position holder;

(5) An ultimate vendor; or

(6) An ultimate vendor (blocked pump).

* * * * *

(f) * * * (1) * * * (i) *Persons other than ultimate vendors, pipeline operators, and vessel operators*. * * *

* * * * *

(ii) *Ultimate vendors, pipeline operators, and vessel operators*. The district director will register an applicant as an ultimate vendor, ultimate vendor (blocked pump), pipeline operator, or vessel operator only if the district director—

* * * * *

(h) * * *

(2) * * *

(iii) Make any false statement on, or violate the terms of, any certificate given to

another person to support an exemption from, or a reduced rate of, the tax imposed by section 4081; or

(iv) In the case of an ultimate vendor (blocked pump), deliver kerosene (or allow kerosene to be delivered) into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train from a blocked pump.

(3) * * * (i) *Notice required with respect to dyed diesel fuel and dyed kerosene*. A legible and conspicuous notice stating "*DYED DIESEL FUEL, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE"* must be provided by each terminal operator to any person that receives dyed diesel fuel at a terminal rack of that operator. A legible and conspicuous notice stating "*DYED KEROSENE, NONTAXABLE USE ONLY, PENALTY FOR TAXABLE USE*" must be provided by each terminal operator to any person that receives dyed kerosene at a terminal rack of that operator. These notices must be provided by the time of the removal and must appear on all shipping papers, bills of lading, and similar documents that are provided by the terminal operator to accompany the removal of the fuel.

* * * * *

(k) * * * For rules relating to claims by registered ultimate vendors (blocked pump), see §48.6427–10.

(l) * * *

(4) References in this section to kerosene are applicable after June 30, 1998.

Par. 51. Section 48.4101–2 is revised to read as follows:

§48.4101–2 Information reporting.

(a) *In general*. Each information report under section 4101(d) must be—

(1) Made in the form required by the Commissioner;

(2) Made for a period of one calendar month; and

(3) Filed by the last day of the first month following the month for which the report is made, except that a report relating to any month during 2000 must be filed by February 28, 2001.

(b) *Effective date*. This section is applicable after March 30, 2000**.**

§§48.4102–2T and 48.4101–3T [Removed]

Par. 52. Sections 48.4102–2T and 48.4101–3T are removed.

§48.4221–1 [Amended]

Par. 53. In §48.4221–1, paragraph (a)(2)(ii) is amended by removing the language "(gasoline and diesel fuel tax)" and adding "(taxable fuel tax)" in its place.

§48.4222(b)–1 [Amended]

Par. 54. In §48.4222(b)–1, paragraph (c), first sentence, is amended by removing the language "paragraph (f)" and adding "paragraph (b)" in its place.

§48.6416(b)(2)–1 [Amended]

Par. 55. Section 48.6416(b)(2)–1 is amended by removing the third sentence.

Par. 56. In §48.6416(b)(2)–2, paragraph (a) is revised to read as follows:

§48.6416(b)(2)–2 Exportations, uses, sales, and resales included.

(a) *In general*. The tax paid under chapter 32 (or under section 4041(a) or (d) in respect of sales or under section 4051) with respect to any article is considered to be an overpayment in the case of any exportation, use, sale, or resale described in this section. This section applies only in those cases in which the exportation, use, sale, or resale (or any combination thereof) referred to in this section occurs before any other use. In addition, the following restrictions must be taken into account in applying the regulations under section 6416(b)(2):

(1) Sections 6416(b)(2)(C) and (D) do not apply to any tax paid under section 4064 (gas guzzler tax).

(2) Sections 6416(b)(2)(B), (C), and (D) do not apply to any tax paid under section 4131 (vaccine tax) and section 6416(b)(2)(A) applies only to the extent prescribed in paragraph (b)(2) of this section.

(3) Section 6416(b)(2) does not apply to any tax paid under section 4041(a)(1) or 4081 on diesel fuel or kerosene, section 4091 (aviation fuel tax), or section 4121 (coal tax).

* * * * *

§48.6420–7 [Removed]

Par. 57. Section 48.6420–7 is removed.

§48.6420(c)–2 [Removed]

Par. 58. Section 48.6420(c)–2 is removed.

§48.6421–2 [Amended]

Par. 59. In §48.6421–2, paragraph (a) is amended by removing the last sentence.

Par. 60. Section 48.6427–8 is amended as follows:

1. The section heading and paragraphs (a) and (b)(1) are revised.

2. Paragraph (b)(2) *Example 1*, paragraph (i) is amended as follows:

a. In the first and second sentences, the language "1996" is removed and "2000" is added in its place.

b. In the fourth sentence, the language "§48.4081–1(h)" is removed and "§48.4081–1(b)" is added in its place.

3. Paragraph (b)(2) *Example 1*, paragraph (ii) is amended by removing the language "(b)(1)(vi)(C)" and adding "(b)(1)(vii)(C)" in its place.

4. Paragraph (b)(2) *Example 2*, paragraph (i) is amended as follows:

a. In the first sentence, the language "1996" is removed and "2000" is added in its place.

b. In the third sentence, the language "or diesel–powered boat" is removed.

5. Paragraph (d) is amended as follows:

a. By removing from paragraph (d)(1) the language "covered by the claim"

b. By revising paragraphs (d)(2) and (d)(3).

c. By adding the language "or kerosene" after "diesel fuel" in paragraphs (d)(4) and (d)(5).

6. Paragraph (f) is revised.

The revisions read as follows:

§48.6427–8 Diesel fuel and kerosene; claims by ultimate purchasers.

(a) *Overview*. This section provides rules under which ultimate purchasers of taxed diesel fuel and kerosene may claim the income tax credits or payments allowed by section 6427(l). Generally, these claims relate to diesel fuel and kerosene used in nontaxable uses. Claims relating to diesel fuel and kerosene sold for use on a farm for farming purposes and by a State are made by registered ultimate vendors under §48.6427–9; claims relating to kerosene sold from a blocked pump are made by registered ultimate vendors (blocked pump) under §48.6427–10; and claims relating to kerosene sold during certain periods of extreme cold for blending with diesel fuel to be used for heating purposes are made by registered ultimate vendors (blending) under §48.6427–11.

(b) *Conditions to allowance of credit or payment*—(1) *In general.* Except as provided in section 6427(l)(5), a claim for an income tax credit or payment with respect to diesel fuel or kerosene is allowed under section 6427(l) only if—

(i) Tax was imposed by section 4081 on the diesel fuel or kerosene to which the claim relates;

(ii) The claimant produced or bought the diesel fuel or kerosene and did not sell it in the United States;

(iii) The claimant has filed a timely claim for a credit or payment that contains the information required under paragraph (d) of this section;

(iv) The diesel fuel or kerosene was not bought under a certificate described in §48.6427–9(e)(2) (relating to Certificate of Farming Use or State Use);

(v) The diesel fuel or kerosene was not used on a farm for farming purposes (as defined in §48.6420–4) or by a State;

(vi) With respect to kerosene, the kerosene was not sold from a blocked pump or sold for blending with diesel fuel under the conditions described in §48.6427–11; and

(vii) The diesel fuel or kerosene was either—

(A) Used in a use described in §48.4082–4(c)(3) through (c)(8);

(B) Exported;

(C) Used other than as a fuel in a propulsion engine of a diesel–powered highway vehicle; or

(D) Used as a fuel in the propulsion engine of a diesel-powered bus if the bus was engaged in a use described in section 6427(b)(1) (after the application of section 6427(b)(3)).

* * * * *

(d) * * *

(2) A statement by the claimant that—

(i) The diesel fuel or kerosene did not contain visible evidence of dye; or

(ii) In the case of diesel fuel or kerosene that contains visible evidence of dye, explains the circumstances under which tax was imposed on that fuel.

(3) The use made of the diesel fuel or kerosene covered by the claim described by reference to specific categories listed in paragraph (b)(1)(vii) of this section (such as use in a qualified local bus or the exclusive use of a nonprofit educational organization).

* * * * *

(f) *Effective date*. This section is applicable with respect to diesel fuel after December 31, 1993, except for paragraph (b)(1)(iv) of this section, which is applicable to diesel fuel bought by ultimate purchasers after June 30, 1994. This section is applicable with respect to kerosene after June 30, 1998.

Par. 61. Section 48.6427–9 is amended as follows:

1. The section heading and paragraph (a) are revised.

2. Paragraph (b) is amended by:

a. Adding the language "or undyed kerosene" after "diesel fuel" in the introductory text.

b. Revising paragraph (b)(2).

3. Paragraph (c) is amended by revising the introductory text, paragraph (c)(1), and paragraph (c)(2) introductory text.

4. Paragraph (e) is amended by adding "or kerosene" after "diesel fuel" in the following locations:

a. Paragraph (e)(1) introductory text.

b. Paragraph (e)(1)(iv).

c. Paragraph (e)(1)(v)(A).

5. Paragraphs (e)(1)(i) and (e)(1)(ii) are revised.

6. Paragraph (e)(1)(vi) is amended by removing the language "For claims relating to sales by the claimant after March 31, 1994, a statement" and adding "A statement" in its place.

7. Paragraph (e)(1)(vii) is removed.

8. Paragraph (e)(2)(ii), Certificate of Farming Use or State Use, is amended by adding or "or kerosene" after "diesel fuel" in each place it appears:

9. Paragraph (g) is revised.

The revisions read as follows:

§48.6427–9 Diesel fuel and kerosene; claims by registered ultimate vendors (farming and State use).

(a) *Overview*. This section provides rules under which certain registered ultimate vendors of taxed diesel fuel and kerosene may claim the income tax credits or payments allowed by section 6427(l)(5)(A). These claims relate to diesel fuel and kerosene sold for use on a farm for farming purposes and by a State. Claims relating to diesel fuel and kerosene used for other nontaxable purposes are made by ultimate purchasers under §48.6427–8; claims relating to kerosene sold from a blocked pump are made by registered ultimate vendors (blocked pump) under §48.6427–10; and claims relating to kerosene sold during certain periods of extreme cold for blending with diesel fuel to be used for heating purposes are made by registered ultimate vendors (blending) under §48.6427–11.

(b) * * *

(2) A *registered ultimate vendor* is an ultimate vendor that is registered under section 4101 as an ultimate vendor.

(c) * * * A claim for an income tax credit or payment with respect to diesel fuel or kerosene is allowed by section 6427(l)(5)(A) only if–

(1) Tax was imposed by section 4081 on the diesel fuel or kerosene to which the claim relates;

(2) The claimant sold the diesel fuel or kerosene to—

* * * * *

(e) * * *(1) * * *

(i) The total number of gallons.

(ii) A statement by the claimant that—

(A) The diesel fuel or kerosene did not contain visible evidence of dye; or

(B) In the case of diesel fuel or kerosene that contains visible evidence of dye, explains the circumstances under which tax was imposed on that fuel.

* * * * *

(g) *Effective date.* This section is applicable with respect to diesel fuel after December 31, 1993, and with respect to kerosene after June 30, 1998.

Par. 62. Sections 48.6427–10 and 48.6427–11 are added to read as follows:

§48.6427–10 Kerosene; claims by registered ultimate vendors (blocked pumps).

(a) *Overview*. This section provides rules under which certain registered ultimate vendors of taxed kerosene may claim the income tax credits or payments allowed by section 6427(l)(5)(B)(i). These claims relate to kerosene sold from a blocked pump. Claims relating to kerosene sold for use on a farm for farming purposes and by a State are made by registered ultimate vendors under §48.6427–9; claims relating to kerosene sold during certain periods of extreme cold for blending with diesel fuel to be used for heating purposes are made by registered ultimate vendors (blending) under §48.6427–11; and claims relating to kerosene used for nontaxable purposes are made by ultimate purchasers under §48.6427–8.

(b) *Definitions*. The following definitions apply to this section:

(1) A *blocked pump* is a fuel pump that—

(i) Is used to dispense undyed kerosene that is sold at retail for use by the buyer in any nontaxable use;

(ii) Is at a fixed location;

(iii) Is identified with a legible and conspicuous notice stating "*UNDYED UNTAXED KEROSENE, NONTAXABLE USE ONLY*"; and

(iv)(A) Cannot reasonably be used to dispense fuel directly into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train (because, for example, of its distance from a road surface or train track or the length of its delivery hose); or

(B) Is locked by the vendor after each sale and unlocked by the vendor only in response to a request by a buyer for undyed kerosene for use other than as a fuel in a diesel-powered highway vehicle or diesel-powered train.

(2) A *registered ultimate vendor (blocked pump)* is a person that is registered under section 4101 as an ultimate vendor (blocked pump).

(3) An *ultimate vendor (blocked pump)* is a person that sells undyed kerosene from a blocked pump.

(c) *Conditions to allowance of credit or payment.* A claim for an income tax credit or payment with respect to undyed kerosene is allowed by section 6427(l)(5)(B)(i) only if—

(1) Tax was imposed by section 4081 on the kerosene to which the claim relates;

(2) The claimant sold the kerosene from a blocked pump for its buyer's use other than as a fuel in a diesel-powered highway vehicle or diesel-powered train and the claimant has no reason to believe that the kerosene will not be so used;

(3) The claimant is a registered ultimate vendor (blocked pump);

(4) With respect to each sale of more than five gallons of kerosene from a blocked pump that does not meet the conditions of paragraph (b)(1)(iv)(A) of this section, the claimant has in its possession the date of the sale, name and address of the buyer, and the number of gallons sold to the buyer; and

(5) The claimant has filed a timely claim for a credit or payment that contains the information required under paragraph (e) of this section.

(d) *Form of claim.* Each claim for an income tax credit under this section must be made on Form 4136 (or such other form as the Commissioner may designate) in accordance with the instructions for that form. Each claim for a payment under this section must be made on Form 8849 (or such other form as the Commissioner may designate) in accordance with the instructions for that form.

(e) *Content of claim.* Each claim for a credit or payment under this section must contain the following information with respect to all of the kerosene covered by the claim:

(1) The claimant's ultimate vendor (blocked pump) registration number.

(2) The total number of gallons.

(3) A statement by the claimant that—

(i) The kerosene did not contain visible evidence of dye; or

(ii) In the case of kerosene that contains visible evidence of dye, explains the circumstances under which tax was imposed on that kerosene.

(4) With respect to each sale of more than five gallons of kerosene from a blocked pump that does not meet the conditions of paragraph (b)(1)(iv)(A) of this section, a statement by the claimant that it has in its possession the date of the sale, name and address of the buyer, and the number of gallons sold to the buyer.

(5) A statement by the claimant that it—

(i) Has not included the amount of the tax in its sales price of the kerosene and has not collected the amount of the tax from its buyer;

(ii) Has repaid the amount of the tax to its buyer; or

(iii) Has obtained the written consent of its buyer to the allowance of the claim.

(f) *Time and place for filing claim.* For rules relating to the time for filing a claim under section 6427, see section 6427(i). A claim under this section is not filed unless it contains all the information required by paragraph (e) of this section and is filed at the place required by the form.

(g) *Cross reference.* For a rule prohibiting a registered ultimate vendor (blocked pump) from delivering kerosene from a blocked pump into the fuel supply tank of a diesel-powered highway vehicle or diesel-powered train, see §48.4101–1(h)(2)(iv).

(h) *Effective date.* This section is applicable after March 30, 2000.

§48.6427–11 Kerosene; claims by registered ultimate vendors (blending).

(a) *Overview.* This section provides rules under which certain registered ultimate vendors of taxed kerosene may claim the income tax credits or payments allowed by section 6427(l)(5)(B)(ii). These claims relate to kerosene sold during certain periods of extreme cold for blending with diesel fuel to be used for heating purposes. Claims relating to kerosene sold for use on a farm for farming purposes and by a State are made by registered ultimate vendors under §48.6427–9; claims relating to kerosene sold from a blocked pump for nontaxable uses are made by registered ultimate vendors (blocked pump) under §48.6427–10; and other claims relating to kerosene used for nontaxable purposes are made by ultimate purchasers under §48.6427–8.

(b) *Definitions.* The following definitions apply to this section:

(1) A *declaration of extreme cold* is a declaration by the Commissioner that a specific geographic area (such as a state or a county within a state) is affected by extremely or unseasonably cold weather conditions. A declaration will be in effect during the period determined by the Commissioner.

(2) A *cold weather blend* is a blend of kerosene and diesel fuel that is produced in an area described in a declaration of extreme cold and that is sold for use or used for heating purposes.

(3) A *registered ultimate vendor (blending)* is a taxable fuel registrant, a registered ultimate vendor, or a registered ultimate vendor (blocked pump).

(c) *Conditions to allowance of credit or payment.* A claim for an income tax credit or payment with respect to kerosene is allowed by section 6427(l)(5)(B)(ii) only if—

(1) Tax was imposed by section 4081 on the kerosene to which the claim relates;

(2) The claimant sold the kerosene in an area described in a declaration of extreme cold for the production of a cold weather blend;

(3) The claimant is a registered ultimate vendor (blending); and

(4) The claimant has filed a timely claim for an income tax credit or payment that contains the information required under paragraph (e) of this section.

(d) *Form of claim.* Each claim for an income tax credit under this section must be made on Form 4136 (or such other form as the Commissioner may designate)

in accordance with the instructions for that form. Each claim for a payment under this section must be made on Form 8849 (or such other form as the Commissioner may designate) in accordance with the instructions for that form.

(e) *Content of claim*—(1) *In general*. Each claim for credit or payment under this section must contain the following information with respect to all of the kerosene covered by the claim:

(i) The claimant's registration number.

(ii) The total number of gallons.

(iii) A statement by the claimant that—

(A) The kerosene did not contain visible evidence of dye; or

(B) In the case of kerosene that contains visible evidence of dye, explains the circumstances under which tax was imposed on that kerosene.

(iv) A statement by the claimant that it—

(A) Has not included the amount of the tax in its sales price of the kerosene and has not collected the amount of the tax from its buyer;

(B) Has repaid the amount of the tax to its buyer; or

(C) Has obtained the written consent of its buyer to the allowance of the claim.

(v) A statement that the claimant has in its possession an unexpired certificate described in paragraph (e)(2) of this section and the claimant has no reason to believe any information in the certificate is false.

(2) *Certificate*—(i) *In general*. The certificate described in this paragraph (e) is a statement by a buyer that is signed under penalties of perjury by a person with authority to bind the buyer, is in substantially the same form as the model certificate provided in paragraph (e)(2)(iii) of this section, and contains all information necessary to complete the model certificate. A certificate must be given for each purchase of kerosene. The certificate may be included as part of any business records normally used to document a sale.

(ii) *Withdrawal of the right to provide a certificate*. The Internal Revenue Service may withdraw the right of a buyer of kerosene to provide a certificate under this section if the buyer uses the kerosene to which a certificate relates other than for producing a cold weather blend. The Internal Revenue Service may notify any seller to whom the buyer has provided a certificate that the buyer's right to provide a certificate has been withdrawn.

(iii) *Model certificate*.

CERTIFICATE OF BUYER FOR PRODUCTION
OF A COLD WEATHER BLEND

(To support vendor's claim for a credit or payment under section 6427 of the Internal Revenue Code.)

_____ (Buyer) certifies the following under penalties of perjury:

Name of Buyer

The kerosene to which this certificate applies will be used by Buyer to produce a blend of kerosene and diesel fuel in an area described in a declaration of extreme cold and the blend will be sold for use or used for heating purposes.

This certificate applies to _____ percent of Buyer's purchases from _____(name, address, and employer identification number of seller) as follows (complete as applicable):

1. A single purchase on invoice or delivery ticket number _____.

2. All purchases between _____ (effective date) and _____ (expiration date) (period not to exceed one year after the effective date) under account or order number(s) _____. If this certificate applies only to Buyer's purchases for certain locations, check here _____ and list the locations.

_____

_____

_____

If Buyer violates the terms of this certificate, the Internal Revenue Service may withdraw Buyer's right to provide a certificate.

Buyer has not been notified by the Internal Revenue Service that its right to provide a certificate has been withdrawn.

Buyer understands that the fraudulent use of this certificate may subject Buyer and all parties making such fraudulent use of this certificate to a fine or imprisonment, or both, together with the costs of prosecution.

_____

Printed or typed name of person signing

_____

Title of person signing

_____

Name of Buyer

_____

Employer identification number

_____

Address of Buyer

_____

Signature and date signed

(f) *Time and place for filing claim*. For rules relating to the time for filing a claim under section 6427, see section 6427(i). A claim under this section is not filed unless it contains all the information required by paragraph (e) of this section and is filed at the place required by the form.

(g) *Effective date*. This section is applicable after March 30, 2000.

§§48.6427–10T and 48.6427–11T [Removed]

Par. 63. Sections 48.6427–10T and 48.6427–11T are removed.

§48.6715–1 [Amended]

Par. 64. Section 48.6715–1 is amended as follows:

1. The section heading is amended by removing the language "diesel".

2. Paragraph (a) is amended by adding "or kerosene" after "diesel fuel" in the following locations:

a. Paragraph (a)(1).

b. Paragraph (a)(2), each place it appears.

c. Paragraph (a)(4), each place it appears.

3. Paragraph (a)(4) is amended by removing the language "§48.6427–8(b)(vi)(C), (D), or (E)" and adding "§48.6427–8(b)(1)(vii)(C) or (D)" in its place.

PART 145–TEMPORARY EXCISE TAX REGULATIONS UNDER THE HIGHWAY REVENUE ACT OF 1982 (PUB. L. 97-424)

Par. 65. The authority citation for part 145 continues to read in part as follows:

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

§145.4051–1 [Amended]

Par. 66. In §145.4051–1, paragraph (f), the first sentence is removed.

Par. 67. Section 145.4052–1 is amended as follows:

1. Paragraph (a)(2)(ii) is revised.

2. Paragraph (a)(7) is removed.

The revision reads as follows:

§145.4052–1 Special rules and definitions.

(a) * * *

(2) * * *

(ii) [Reserved]. For sales after June 30, 1998, see §48.4052–1 of this chapter,

* * * * *

PART 602–OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 68. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 69. In §602.101, paragraph (b) is amended by:

1. Removing the following entries from the table:

41.4481–1T
41.4482(b)–1T
48.4081–2(c)(3)
48.4081–3(d)(2)(ii)
48.4081–3(e)(2)(ii)
48.4081–3(f)(2)(ii)
48.4081–9
48.4082–7T
48.4082–8T
48.4091–3T
48.4101–2T
48.4101–3T
48.6420(c)–2
48.6420–7
48.6427–11T

2. Revising the entries for 48.4081–7 and 145.4052–1 and adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved March 15, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 31, 2000, 65 F.R. 17149)

CFR Part or Section Where Identified and Described	Current OMB Control No.
* * * * *	
48.4052–1	1545-1418
* * * * *	
48.4081–2	1545-1270
	1545-1418
48.4081–3	1545-1270
	1545-1418
* * * * *	
48.4081–7	1545-1270
	1545-1418
* * * * *	
48.4082–6	1545-1418
48.4082–7	1545-1418
48.4091–3	1545-1418
* * * * *	
48.6427–10	1545-1418
48.6427–11	1545-1418
* * * * *	
145.4052–1	1545-0120
	1545-0745
	1545-1076
* * * * *	

Section 6721.—Failure to File Correct Information Returns

26 CFR 301.6721–1: Failure to file correct information returns.

Will the Service impose penalties under §§ 6721 and 6722 of the Code on certain taxpayers newly subject to § 6050P for failure to file information returns or furnish payee statements under § 6050P for discharges of indebtedness occurring before January 1, 2001. See Notice 2000–22, page 902.

Section 6722.—Failure to Furnish Correct Payee Statements

26 CFR 301.6722–1: Failure to furnish correct payee statements.

Will the Service impose penalties under §§ 6721 and 6722 of the Code on certain taxpayers newly subject to § 6050P for failure to file information returns or furnish payee statements under § 6050P for discharges of indebtedness occurring before January 1, 2001. See Notice 2000–22, page 902.

Part III. Administrative, Procedural, and Miscellaneous

Information Reporting for Discharges of Indebtedness

Notice 2000–22

PURPOSE

This notice provides that the Internal Revenue Service will not impose penalties under §§ 6721 and 6722 of the Internal Revenue Code on certain taxpayers for failure to file information returns or furnish payee statements under § 6050P for discharges of indebtedness occurring before January 1, 2001. This notice applies only to taxpayers who were made subject to § 6050P by § 533(a) of the Ticket to Work and Work Incentives Improvement Act of 1999, Pub. L. No. 106–170, 113 Stat. 1860, 1931 (1999) ("the Act").

BACKGROUND

Generally, § 6050P(a) requires applicable entities that are subject to that section to file returns with the Service, and to provide statements to persons whose names are required to be shown on the returns ("payees"), setting forth certain information regarding discharges of indebtedness of $600 or more. Sections 6721 and 6722 impose penalties for failure to file correct information returns or to provide correct payee statements, respectively, including those required under § 6050P.

Section 533(a) of the Act amended § 6050P of the Code by expanding the types of entities that are required to report discharges of indebtedness to include any organization "a significant trade or business of which is the lending of money." The Act was signed into law on December 17, 1999. Section 533(a) was made effective for discharges of indebtedness occurring after December 31, 1999.

PENALTY SUSPENSION

The Service recognizes that many taxpayers that were made subject to § 6050P by the Act did not have sufficient time to make the necessary changes to their record keeping systems to capture the information required to be reported under § 6050P. In addition to the fact that § 533(a) of the Act became effective very shortly after enactment, many taxpayers were, at the time of enactment, focused on implementing computer system changes in preparation for Year 2000. To give these taxpayers additional time to make the changes necessary to comply with § 6050P, the Service will not impose penalties on these taxpayers for failing to comply with the requirements of § 6050P for discharges of indebtedness occurring before January 1, 2001.

This notice does not affect the reporting obligations of any entity that was already subject to § 6050P prior to its amendment by the Act.

DRAFTING INFORMATION

The principal author of this notice is Christopher F. Kane of the Office of Assistant Chief Counsel, Income Tax and Accounting. For further information regarding this notice, contact Mr. Kane at (202) 622-4930 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Special Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans

REG–109101–98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that would permit qualified defined contribution plans to be amended to eliminate some alternative forms in which an account balance can be paid under certain circumstances, and would permit certain transfers between defined contribution plans that are not permitted under regulations now in effect. These proposed regulations affect qualified retirement plan sponsors, administrators, and participants. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by June 27, 2000. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for June 27, 2000, at 10 a.m., must be received by June 6, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–109101–98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–109101–98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.gov/tax_regs/reglist.html. The public hearing will be held in room 6718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Linda S. F. Marshall, 202-622-6030; concerning submissions and the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke, 202-622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 1 under section 411(d)(6) of the Internal Revenue Code of 1986 (Code).

Section 411(d)(6) generally provides that a plan will not be treated as satisfying the requirements of section 411 if the accrued benefit of a participant is decreased by a plan amendment. Section 411(d)(6)(B), which was added by the Retirement Equity Act of 1984 (REA), Public Law 98-397 (98 Stat. 1426), provides that a plan amendment that eliminates an optional form of benefit is treated as reducing accrued benefits to the extent that the amendment applies to benefits accrued as of the later of the adoption date or the effective date of the amendment. However, section 411(d)(6)(B) authorizes the Secretary of the Treasury to provide exceptions to this requirement. This authority does not extend to a plan amendment that would have the effect of eliminating or reducing an early retirement benefit or a retirement-type subsidy.

Final regulations regarding section 411(d)(6)(B) were published in the **Federal Register** on July 8, 1988. Those final regulations, and subsequent amendments to the regulations, define the optional forms of benefit that are protected under section 411(d)(6)(B) and provide for certain exceptions to the general rule of section 411(d)(6)(B). In general, existing regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit have been developed to address certain specific practical problems. For example, §1.411(d)–4, Q&A-3(b) permits a transfer between plans of a participant's entire nonforfeitable benefit to be made at the election of the participant, without a requirement that the transferee plan preserve all section 411(d)(6) protected benefits, but only if the participant is eligible to receive an immediate distribution and certain other conditions are satisfied. In addition, some regulatory exceptions to the application of section 411(d)(6)(B) to optional forms of benefit address plan amendments that are related to statutory changes. See Q&A-2(b) and Q&A-10 of §1.411(d)–4.

The IRS and Treasury recognize that the accumulation of a variety of payment choices in a plan may increase the cost and complexity of plan operations. For example, an employer that initially adopted a plan for which the plan document was prepared by a prototype sponsor may now be using a different prototype plan that offers a different array of distribution forms. The requirement to preserve virtually all preexisting optional forms for benefits accrued up to the date of change in the prototype plan may present significant practical problems in certain cases.

Similar issues arise where employers merge with or acquire other businesses. These employers often face issues of whether to maintain separate plans, terminate one or more of the plans, or merge the plans. If the employer chooses to merge the plans, the resulting plan may accumulate a wide variety of optional forms, some of which may differ in insignificant ways or may entail special administrative costs. Because the existing elective transfer rule of §1.411(d)–4, Q&A-3(b) applies only to situations in which a participant's benefits have become distributable, its applicability is limited.

In recent years, it has become easier for individuals to replicate the various payment choices available from qualified plans through other means. The Unemployment Compensation Amendments of 1992, Public Law 102-318 (106 Stat. 290), substantially expanded participants' ability to transfer distributions from qualified plans to individual retirement arrangements (IRAs) on a tax-deferred basis. Individuals who receive single-sum distributions from qualified plans frequently roll those distributions over directly to IRAs, under which distributions can be made in a wide variety of payment forms. There are also indications that the vast majority of participants in defined contribution plans who are given a choice

of distribution forms that includes a single-sum distribution elect the single-sum distribution.

The IRS and Treasury have been weighing these considerations as they apply to various circumstances and various benefit forms. As a result, the IRS and Treasury have been considering the appropriateness of exercising the regulatory authority under section 411(d)(6)(B) to provide additional exceptions under that provision, in order to allow greater flexibility for sponsors to modify alternative forms of payment and simplify plan provisions and plan administration.

Notice 98–29 (1998–1 C.B. 1163) requested public comment on several ways of providing regulatory relief from the requirements of section 411(d)(6)(B) for defined contribution plans. Most of the public comments received in response to Notice 98–29 indicate that, particularly for defined contribution plans, the section 411(d)(6)(B) requirement that a plan continue to offer all existing payment options often imposes significant administrative burdens that are disproportionate to any corresponding benefit to participants. Accordingly, after considering the comments received in response to Notice 98–29, the IRS and Treasury are issuing these proposed regulations, which would provide relief from the requirements of section 411(d)(6)(B) in a wide range of circumstances.

As anticipated in Notice 98–29, the primary focus of these regulations is on defined contribution plans, and the provisions of these regulations relating to elimination of alternative forms of payment are limited to defined contribution plans. Defined benefit plans have special characteristics, including benefit payment calculation specifications, early retirement benefits, and other retirement-type subsidies (for which section 411(d)(6)(B) does not authorize the issuance of regulatory relief). Features such as these are not characteristic of defined contribution plans and provide important protections to participants. While limited comments relating to defined benefit plans were received in response to Notice 98–29, the IRS and Treasury remain open to further comment in this area. As discussed below, the provisions of these proposed regulations relating to elimination of in-kind distributions extend to both defined contribution plans and defined benefit plans, and the provisions of these proposed regulations relating to transfers between plans apply to defined contribution plans and, to some extent, to defined benefit plans.

These proposed regulations would not affect other requirements of the Code. For example, a money purchase pension plan (or a plan otherwise described in section 401(a)(11)(B)) generally must satisfy certain requirements relating to qualified joint and survivor annuities and qualified preretirement survivor annuities. Similarly, these proposed regulations would not affect the requirements of section 401(a)(31) relating to direct rollovers.

Explanation of Provisions

A. *Permitted Amendments to Alternative Forms of Payment Under a Defined Contribution Plan*

The proposed regulations would simplify plan administration and allow greater flexibility by significantly expanding the permitted changes that may be made to alternative forms of payment under a defined contribution plan. Instead of requiring defined contribution plans to continue to maintain nearly all existing alternative forms of payment with only limited exceptions, these proposed regulations would permit defined contribution plans to be amended to eliminate nearly all existing forms of payment if certain specified forms of payment are available. Under the proposed regulations, a defined contribution plan would not violate the requirements of section 411(d)(6) merely because the plan was amended to eliminate or restrict the ability of a participant to receive payment of the participant's accrued benefit under a particular optional form of benefit if, after the plan amendment became effective with respect to the participant, the distribution choices available to the participant included both payment of the accrued benefit in a single-sum distribution form and payment of the accrued benefit in an extended distribution form, each of which is otherwise identical to the eliminated or restricted optional form of benefit.

Under the proposed regulations, a distribution form is an otherwise identical distribution form with respect to an optional form of benefit that is eliminated or restricted only if the distribution form is identical in all respects to the eliminated or restricted optional form of benefit except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not an otherwise identical distribution form with respect to a specified installment form of benefit if the single-sum distribution form is not available for distribution on any date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, does not apply to the benefit to which the installment form applied, imposes any condition of eligibility that did not apply to the installment form, or lacks any related election rights that were available with respect to the installment form. However, a distribution form does not fail to be identical just because it provides greater rights to the participant. Further, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features are not otherwise protected under section 411(d)(6). Moreover, in the case of an optional form of benefit that is in the form of an annuity and that provides for distribution of an annuity contract, a distribution form that is not in the form of an annuity would not fail to be an otherwise identical distribution form with respect to that optional form of benefit merely because the non-annuity distribution form does not provide for distribution of an annuity contract.

The requirement under the proposed regulations that an extended distribution form be retained would be satisfied if the plan provided either (1) a life annuity or (2) periodic payments over the participant's life expectancy (or, at the election of the participant, over the joint life expectancy of the participant and the participant's spouse). Thus, a defined contribution plan would not violate section 411(d)(6) merely because of a plan amendment that replaced an optional form of benefit payable under the plan with either of these two extended distribution forms, together with a single-sum distribution form, provided that the single-sum distribution form and the extended distribution form are each otherwise identical to the replaced optional

form of benefit. A plan providing for periodic payments over life expectancy could provide for the life expectancy to be fixed when payments begin or, alternatively, could provide for the life expectancy to be redetermined annually as described in section 401(a)(9)(D).

As noted above, the proposed regulations would not affect the survivor annuity requirements of sections 401(a)(11) and 417. Thus, for example, as required under sections 401(a)(11) and 417, any profit-sharing plan that provides for payment in the form of a life annuity (whether or not the life annuity was added to the plan in lieu of some other optional form) would also be required to offer payment in the form of a qualified joint and survivor annuity.

A third extended distribution form would generally be permitted under the proposed regulations for a plan amendment that did not eliminate any optional form of benefit that is an extended distribution form described above. For such an amendment, the requirement to provide an extended distribution form would be satisfied if the plan offered a distribution in the form of substantially equal periodic payments made (not less frequently than annually) over a period at least as long as the longest period over which the participant is entitled to receive a distribution under the plan before the plan amendment under any of the optional forms of benefit that are eliminated by the plan amendment. Thus, for example, a defined contribution plan that offers distributions in the form of a single-sum distribution, 5-year installment payments, 10-year installment payments, 15-year installment payments, and 20-year installment payments could be amended to offer only a single-sum distribution and 20-year installment payments, each of which is otherwise identical to the formerly available 5-year, 10-year, and 15-year distribution forms.

The provisions of the proposed regulations permitting payment forms to be eliminated if the defined contribution plan retains a single-sum distribution form and an extended distribution form are similar to one of the proposals outlined in Notice 98–29. In response to Notice 98–29, commentators generally stated that implementing this relief would be very helpful for plan sponsors, but there was also substantial comment urging further relief, so that a defined contribution plan with a single-sum distribution option would not also be required to continue to offer an extended distribution form. These commentators took the position that, in light of a participant's ability to roll over distributions to IRAs, which may offer multiple payment forms, there is only a marginal advantage to the participant in requiring the retention of an option to receive extended payments from a qualified defined contribution plan.

Some of these comments described plans that have been preserving a variety of payment options because the regulations require it, even though certain of the options have not been selected by a single participant for years. Commentators asserted that ultimately, employee demand would tend to shape the array of payment options offered by plan sponsors, and that plan sponsors generally would feel more free to offer or "test market" various payment form alternatives to participants if the sponsors were not legally prohibited from ever removing any option, once offered, even when participants in the plan have evidenced little or no interest in the option. Commentators observed that participants would in all events continue to have the option to leave their account balance in the plan (if above the $5,000 cashout threshold) until they were ready to begin receiving distributions. It was argued that the vast majority of participants are not ready to begin drawing lifetime retirement benefits at the time their employment with a particular plan sponsor terminates, and that, accordingly, a participant's rollover to a single IRA of the participant's benefits from a series of employer-sponsored plans over the course of the participant's working life is an effective and common means of achieving portability, consolidation, and preservation of retirement savings.

Commentators also asserted that the protections of section 411(d)(6)(B) may have adversely affected participants involved in corporate sale transactions. Specifically, some sellers and buyers that might otherwise have merged their plans, or transferred benefits under the seller's plan to the buyer's plan, instead have terminated the seller's plan or made distributions in order to avoid being required to preserve all of the distribution forms in the seller's plan.

Although the comments received in response to Notice 98–29 made a strong case that only a single sum distribution should be required to be retained, these proposed regulations reflect the view that the advantages to participants from retaining an extended distribution form may be worth the plan administration costs of retaining this additional option. These advantages include the benefits that participants, especially less sophisticated participants, can derive from employer involvement, which is subject to the fiduciary standards, in selecting and monitoring investment options under the plan after retirement distributions have begun. The IRS and Treasury are open to further comments on whether or not an extended distribution form should be required to be preserved, including comments that identify circumstances in which it may be acceptable for a plan not to preserve an extended distribution form. In particular, comments are requested on whether the final regulations should provide any of the following further relief:

- Should an extended distribution form be required to be retained only for participants who have reached a specified age, such as age 55, age 62, or normal retirement age, at the time of the distribution?
- Should there be an exception from this requirement for small businesses (e.g., employers with fewer than 100 employees or fewer than 25 employees)?
- Should a plan be treated as satisfying the requirement that it retain an extended distribution form if the plan allows a participant to elect to receive distribution by transfer of his or her vested account to a defined benefit plan for distribution in an extended distribution form?
- Should a plan be treated as satisfying the requirement that it retain an extended distribution form if the plan offers installment payments over a fixed period, such as 20 years?
- Should there be an exception from the requirement that an extended distribution form be retained if a plan with an extended distribution form is merged into another plan that does not offer an extended distribution form (for example, if the plan with-

out the extended distribution form has a larger number of participants) in connection with an asset or stock acquisition, merger, or similar transaction involving a change in employer of the employees of a trade or business?

- If extended distribution forms are permitted to be eliminated, should there be additional protections, such as requiring that the amendment not go into effect for a specified period (such as two, four, or five years) or that the amendment not apply to participants who have reached a specified age (such as age 55, age 62, or normal retirement age) at the time of the amendment, or both?

Approaches such as these may be considered either independently of each other, as a series of coordinated alternatives, or in combination (such as permitting small businesses to limit the availability of extended distribution forms to participants who receive distributions after attaining a specified age, or such as permitting plan amendments that make extended distribution forms available only to participants who reach a specified age before a specified date, such as five years after the amendment). Commentators are requested to identify the burdens in plan administration that may be reduced by any of these approaches and the extent to which the approaches involve elimination of distribution alternatives that may be important to a participant.

B. *Voluntary Direct Transfers Between Plans*

The proposed regulations would make a number of changes in the existing regulations relating to elective transfers between qualified plans. Under certain circumstances, the existing regulations permit elimination of optional forms of benefit in connection with plan transfers with a participant's consent. The proposed regulations would significantly liberalize the application of these elective transfer provisions.

The existing regulations do not permit an elective transfer from one qualified plan to another unless the participant's benefit under the transferring plan is immediately distributable. This condition has precluded use of the elective transfer provision in the existing regulations in connection with merger and acquisition transactions involving plans with a cash or deferred arrangement under section 401(k) in cases in which benefits under the cash or deferred arrangement are not distributable because section 401(k)(10) is not applicable. Many commentators have stated that permitting elective transfers from the former employer's section 401(k) plan to the new employer's section 401(k) plan under these circumstances would allow employers to permit employees to keep their old retirement benefits in a qualified plan together with their newly earned retirement benefits, particularly in cases where the new employer chooses not to maintain the former employer's plan.

The proposed regulations would grant broad section 411(d)(6) relief for many types of elective transfers of a participant's entire benefit, without regard to whether the participant's benefit is immediately distributable. The elective transfer provision would be available for transfers made in connection with certain corporate transactions (such as a merger or acquisition), or in connection with the transfer of a participant to a different job (for example, to a different subsidiary or division of the employer) that is not covered by the transferor plan, even if the event is not one that allows a distribution. Insofar as the immediately distributable requirement of the existing regulations would be eliminated, the proposed regulations would permit an elective transfer even if the participant's benefit is not fully vested, provided that the requirements of section 411(a)(10) are satisfied. The proposed regulations would not restrict the permissible types of elective transfers to transfers between plans of the same employer. Accordingly, elective transfers could be made to plans that are within the employer's controlled group or to plans that are outside the employer's controlled group.

The proposed regulations would provide section 411(d)(6) relief for elective transfers involving corporate transactions or employee job transfers generally where the defined contribution plans are of the same type (e.g., from a qualified cash or deferred arrangement under section 401(k) to another qualified cash or deferred arrangement). The restrictions on the types of plans between which transfers would be permitted would ensure that amounts transferred to the receiving plan will be subject to similar legal restrictions with respect to in-service distributions. See Rev. Rul. 94–76 (1994–2 C.B. 46). In the case of transfers from plans that are subject to the survivor annuity requirements under sections 401(a)(11) and 417, those survivor annuity requirements would apply to the receiving plan with respect to the transferred amount in accordance with the transferee plan rules of section 401(a)(11)(B)(iii)(III).

The existing regulations relating to elective transfers were issued in 1988. Since then, section 401(a)(31) has been enacted. Under section 401(a)(31), any eligible rollover distribution may be directly rolled over to an IRA or to another eligible retirement plan. The section 411(d)(6) requirements do not apply to amounts that have been distributed, such as distributions that are directly rolled over to another plan under section 401(a)(31). Accordingly, the elective transfer rules of the existing regulations have largely been duplicated by the enactment of section 401(a)(31) because the same result generally is available through a direct rollover. The proposed regulations would eliminate this duplication by replacing the elective transfer rules of the existing regulations that apply to immediately distributable amounts, except for certain transfers of amounts that are not eligible rollover distributions (such as amounts attributable to after-tax employee contributions). Specifically, an elective transfer of an immediately distributable amount would be permitted to the extent the amount is not an eligible rollover distribution, if the participant's entire nonforfeitable accrued benefit is transferred by means of a combination of a section 401(a)(31) transfer and the elective transfer. This rule would apply to transfers between defined benefit plans, as well as transfers between defined contribution plans. Comments are requested regarding whether there are other situations (where direct rollovers are unavailable) to which the elective transfer approach should apply.

C. *Rules Regarding In-Kind Distributions*

The proposed regulations clarify and modify the rules regarding the application of the protections of section 411(d)(6)(B) to a right to receive benefit distributions in kind with respect to defined contribution plans and defined benefit plans. Provisions for distribution in kind are sometimes found in plans invested in annuity contracts or in marketable mutual funds. The right to a particular form of investment is not a protected optional form of benefit. However, the investments made by a plan generally are subject to fiduciary requirements, including the prudence requirement of section 404(a)(1)(B) of the Employee Retirement Income Security Act of 1974, Public Law 93-406 (88 Stat. 829). The existing regulations state that the right to a medium of distribution, such as cash or in-kind payments, is an optional form of benefit to which section 411(d)(6)(B) applies.

Under the proposed regulations, if a defined benefit plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract, that optional form of benefit could be modified by substituting cash for the annuity contract. Thus, a defined benefit plan that provides for distribution of an annuity contract could be amended to substitute cash payments from the plan that are identical in all respects protected by section 411(d)(6) to the payments available from the annuity contract except with respect to the source of the payments. Comments are requested regarding whether any additional section 411(d)(6)(B) relief for non-cash distributions is appropriate for defined benefit plans.

The proposed regulations would permit a defined contribution plan to be amended to replace the ability to receive a distribution in the form of marketable securities (other than employer securities) with the ability to receive a distribution in the form of cash. The right to distributions from a defined contribution plan in the form of cash, employer securities or other property that is not marketable securities would generally be protected. However, the proposed regulations would also permit a defined contribution plan that gives a participant the right to an in-kind distribution (including employer securities and property that is not marketable securities) to be amended to limit the types of property in which distributions could be made to the participant to specific types of property in which the participant's account is invested at the time of the amendment (and with respect to which the participant had the right to receive an in-kind distribution before the plan amendment). In addition, the proposed regulations would permit a defined contribution plan giving a participant the right to a distribution in a type of property to be amended to specify that the participant is permitted to receive a distribution in that type of property only to the extent that the plan assets held in the participant's account at the time of the distribution include that type of property. These provisions of the proposed regulations would not permit a plan to be amended in a way that would affect protected features of optional forms of benefit other than the medium of distribution. Thus, for example, a plan could not be amended to eliminate a participant's right to payments over a period of years, regardless of the plan's current investments, except as permitted under other provisions of the current or proposed regulations (such as the provisions described above relating to permitted plan amendments affecting alternative forms of payment under defined contribution plans).

Comments are requested on whether section 411(d)(6) protection for in-kind distributions of employer securities and property that is not marketable securities from defined contribution plans should be preserved or eliminated. Commentators are requested to address the extent to which these may be important rights for participants. For example, in a defined contribution plan that does not give participants the right to payment in kind, it is possible that a distribution made in cash for a particular asset may be in an amount that is less than the value that the participant assigns to the asset. Commentators are further requested to address the potential administrative burden if, as proposed, plans are prohibited from eliminating these media of distribution. Comments are also requested on whether section 411(d)(6)(B) protection should be retained for any form of in-kind distribution from a defined contribution plan other than employer securities and property that is not marketable securities.

Proposed Effective Date

The proposed regulations are proposed to be effective upon publication of final regulations in the **Federal Register** and cannot be relied upon before finalization.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their 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 (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. In addition to the other requests for comments set forth in this document, the IRS and Treasury also request comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for June 27, 2000, at 10 a.m., in room 6718, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th street entrance, located between Constitution and Pennsylvania Avenues, NW. 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 15 minutes

before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons who wish to present oral comments at the hearing must submit written comments by June 6, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 6, 2000.

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 Linda S. F. Marshall of the Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury participated in their development.

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Proposed Amendments to the Regulations

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

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

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

Par. 2. Section 1.411(d)–4 is amended as follows:

1. In Q&A-1, paragraph (b)(1), the last sentence is amended by removing the language "§1.401(a)(4)–4(d)" and adding "§1.401(a)(4)–4(e)(1)" in its place.

2. Q&A-2 is amended by:

a. Revising paragraph (b)(2)(iii).

b. Adding paragraph (e).

3. Q&A-3 is amended by:

a. Revising paragraph (a)(3).

b. Adding paragraph (a)(4).

c. Revising paragraphs (b), (c), and (d).

d. Adding paragraph (e).

The additions and revisions read as follows:

§1.411(d)–4 Section 411(d)(6) protected benefits.

* * * * *

A-2: * * *

(b) * * *

(2) * * *

(iii) *In-kind distributions*–(A) *Distributions of annuity contracts payable under defined benefit plans.* If a defined benefit plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract, that optional form of benefit may be modified by substituting cash for the annuity contract.

(B) *In-kind distributions payable under defined contribution plans in the form of marketable securities other than employer securities*. If a defined contribution plan includes an optional form of benefit under which benefits are distributed in the form of marketable securities, other than securities of the employer, that optional form of benefit may be modified by substituting cash for the marketable securities. For purposes of this paragraph (b)(2)(iii), the term *marketable securities* means marketable securities as defined in section 731(c)(2), and the term *securities of the employer* means securities of the employer as defined in section 402(e)(4)(E)(ii).

(C) *Amendments to defined contribution plans to specify medium of distribution*. If a defined contribution plan includes an optional form of benefit under which benefits are distributable to a participant in a medium other than cash, the plan may be amended to limit the types of property in which distributions may be made to the participant to the types of property specified in the amendment. For this purpose, the types of property specified in the amendment must include all types of property (other than types of property for which the plan may be amended to substitute cash under paragraph (b)(2)(iii)(B) of this Q&A-2) that are held in the participant's account on the effective date of the amendment and in which the participant would be able to receive a distribution immediately before the effective date of the amendment. In addition, a plan amendment may provide that the participant's right to receive a distribution in the form of specified types of property is limited to the property held in the participant's account at the time of distribution that consists of property of those specified types.

(D) *In-kind distributions after plan termination*. If a plan includes an optional form of benefit under which benefits are distributed in specified property, that optional form of benefit may be modified for distributions after plan termination by substituting cash for the specified property to the extent that, on plan termination, an employee has the opportunity to receive the optional form of benefit in the form of the specified property. This exception is not available, however, if the employer that maintains the terminating plan also maintains another plan that provides an optional form of benefit under which benefits are distributed in the specified property.

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

Example 1. (i) An employer maintains a profit-sharing plan under which participants may direct the investment of their accounts. One investment option available to participants is a fund invested in common stock of the employer. The plan provides that the participant has the right to a distribution in the form of cash upon termination of employment. In addition, the plan provides that, to the extent a participant's account is invested in the employer stock fund, the participant may receive an in-kind distribution of employer stock upon termination of employment. On September 1, 2000, the plan is amended, effective on January 1, 2001, to remove the fund invested in employer common stock as an investment option under the plan and to provide for the stock held in the fund to be sold. The amendment permits participants to elect how the sale proceeds are to be reallocated among the remaining investment options, and provides for amounts not so reallocated as of January 1, 2001, to be allocated to a specified investment option.

(ii) The plan does not fail to satisfy section 411(d)(6) solely on account of the plan amendment relating to the elimination of the employer stock investment option, which is not a section 411(d)(6) protected benefit. See paragraph (d)(7) of Q&A-1 of this section. Moreover, because the plan did not provide for distributions of employer securities except to the extent participants' accounts were invested in the employer stock fund, the plan is not required operationally to offer distributions of employer securities following the amendment. In addition, the plan would not fail to satisfy section 411(d)(6) on account of a further plan amendment, effective after the plan has ceased to provide for an employer stock fund investment option, to eliminate the right to a distribution in the form of employer stock. See paragraph (b)(2)(iii)(C) of this Q&A-2.

Example 2. (i) An employer maintains a profit-sharing plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution either in cash or in kind. The plan's investments are limited to a fund invested in employer stock, a fund invested in XYZ

mutual funds (which are marketable securities), and a fund invested in shares of PQR limited partnership (which are not marketable securities).

(ii) The following alternative plan amendments would not cause the plan to fail to satisfy section 411(d)(6):

(A) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership. See paragraph (b)(2)(iii)(B) of this Q&A-2.

(B) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that also lists the participants that hold employer stock in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of employer stock, and lists the participants that hold shares of PQR limited partnership in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of shares of PQR limited partnership. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

(C) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership to the extent that the participant's account is invested in those assets at the time of the distribution. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

(D) A plan amendment that limits non-cash distributions to a participant on termination of employment to a distribution of employer stock and shares of PQR limited partnership, and that lists the participants that hold employer stock in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of employer stock, and lists the participants that hold shares of PQR limited partnership in their accounts as of the effective date of the amendment and provides that only those participants have the right to distributions in the form of shares of PQR limited partnership, and further provides that the distribution of that stock or those shares is available only to the extent that the participants' accounts are invested in those assets at the time of the distribution. See paragraphs (b)(2)(iii)(B) and (C) of this Q&A-2.

Example 3. (i) An employer maintains a stock bonus plan under which a participant, upon termination of employment, may elect to receive benefits in a single-sum distribution in employer stock. This is the only plan maintained by the employer under which distributions in employer stock are available. The employer decides to terminate the stock bonus plan.

(ii) If the plan makes available a single-sum distribution in employer stock on plan termination, the plan will not fail to satisfy section 411(d)(6) solely because the optional form of benefit providing a single-sum distribution in employer stock on termination of employment is modified to provide that such distribution is available only in cash. See paragraph (b)(2)(iii)(D) of this Q&A-2.

* * * * *

(e) *Permitted plan amendments affecting alternative forms of payment under defined contribution plans*—(1) *General rule*. A defined contribution plan does not violate the requirements of section 411(d)(6) merely because the plan is amended to eliminate or restrict the ability of a participant to receive payment of accrued benefits under a particular optional form of benefit if, after the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in both a single-sum distribution form and an extended distribution form described in paragraph (e)(3) of this Q&A-2, each of which is an otherwise identical distribution form with respect to the optional form of benefit that is being eliminated or restricted.

(2) *Otherwise identical distribution form*. For purposes of this paragraph (e), a distribution form is an otherwise identical distribution form with respect to an optional form of benefit that is eliminated or restricted pursuant to paragraph (e)(1) of this Q&A-2 only if the distribution form is identical in all respects to the eliminated or restricted optional form of benefit (or would be identical except that it provides greater rights to the participant) except with respect to the timing of payments after commencement. For example, a single-sum distribution form is not an otherwise identical distribution form with respect to a specified installment form of benefit if the single-sum distribution form is not available for distribution on the date on which the installment form would have been available for commencement, is not available in the same medium of distribution as the installment form, does not apply to the benefit (or any portion of the benefit) to which the installment form applied, imposes any condition of eligibility that did not apply to the installment form, or lacks any related election rights that were available with respect to the installment form. However, the single-sum distribution form would not fail to be an otherwise identical distribution form with respect to the installment form merely because the single-sum distribution form is available for distribution on a date on which the installment form would not have been available for commencement, is available in media of distribution that the installment form was not, applies (if the participant so chooses) to a larger portion of the benefit than the installment form, has fewer or less stringent conditions of eligibility than the installment form, or has election rights that the installment form lacked. In addition, an otherwise identical distribution form need not retain rights or features of the optional form of benefit that is eliminated or restricted to the extent that those rights or features are not otherwise protected under section 411(d)(6). Moreover, in the case of an optional form of benefit that is in the form of an annuity and that provides for distribution of an annuity contract, a distribution form that is not in the form of an annuity does not fail to be an otherwise identical distribution form with respect to that optional form of benefit merely because the nonannuity distribution form does not provide for distribution of an annuity contract.

(3) *Extended distribution form*–(i) *In general*. For purposes of this paragraph (e), a distribution form is an extended distribution form if it is—

(A) An annuity payable for the life of the participant;

(B) Substantially equal periodic payments made (not less frequently than annually), at the election of the participant, over either the life expectancy of the participant or the joint life expectancy of the participant and the participant's spouse (with or without redetermination of those life expectancies, as described in section 401(a)(9)(D)); or

(C) For a plan amendment that does not eliminate any optional form of benefit that is an extended distribution form described in paragraph (e)(3)(i)(A) or (B) of this Q&A-2, substantially equal periodic payments made (not less frequently than annually) over a period at least as long as the longest period over which the participant is entitled to receive a distribution under the plan before the plan amendment under any of the optional forms of benefit that are eliminated by the plan amendment.

(ii) *Substantially equal periodic payments*. For purposes of this paragraph (e)(3), the rules of section 402(c)(4)(A)(ii) and §1.402(c)–2, Q&A-5, apply in determining whether payments are substantially equal periodic payments (but without regard to the 10-year minimum period for payments and

without regard to §1.402(c)–2, Q&A-5(b), regarding certain periodic payments that decrease upon a participant's attainment of eligibility for social security benefits).

(4) *Examples*. The following examples illustrate the application of this paragraph (e):

Example 1. (i) P is a participant in Plan M, a qualified profit-sharing plan that is invested in mutual funds. The distribution forms available to P under Plan M include a distribution of P's vested account balance under Plan M in the form of distribution of various annuity contract forms (including a single life annuity and a joint and survivor annuity). The annuity payments under the annuity contract forms begin as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)). P has not previously elected payment of benefits in the form of a life annuity, and Plan M is not a direct or indirect transferee of any plan that is a defined benefit plan or a defined contribution plan that is subject to section 412. Plan M provides that distributions on the death of a participant are made in accordance with section 401(a)(11)(B)(iii)(I). Plan M is amended so that, after the amendment is effective, P is no longer entitled to any distribution in the form of the distribution of an annuity contract. However, after the amendment is effective, P is entitled to receive a single-sum cash distribution of P's vested account balance under Plan M payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)). In addition, P is entitled to receive P's vested account balance under Plan M payable in substantially equal monthly payments made, at P's election, over either P's life expectancy or the joint life expectancies of P and P's spouse, beginning as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)).

(ii) Plan M does not violate the requirements of section 411(d)(6) (or section 401(a)(11)) merely because the plan amendment has eliminated P's option to receive a distribution in any of the various annuity contract forms previously available.

Example 2. (i) P is a participant in Plan M, a qualified profit-sharing plan to which section 401(a)(11)(A) does not apply. Upon termination of employment, P is entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, subject to the requirements of section 401(a)(9)), in the form of a single-sum distribution, or in substantially equal monthly installment payments over either 5, 10, 15, or 20 years. Plan M is amended so that, after the amendment is effective, P is no longer entitled to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, or 15 years. However, after the amendment is effective, P continues to be entitled to receive cash distributions from Plan M, payable as of the first day of the month following P's termination of employment (or as of the first day of any subsequent month, except as required by section 401(a)(9)), in the form of a single-sum distribution or in substantially equal monthly installment payments over 20 years.

(ii) Plan M does not violate the requirements of section 411(d)(6) merely because the plan amendment has eliminated P's option to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, or 15 years.

(5) *Effective date*. This paragraph (e) applies to plan amendments that are adopted and made effective after the date of publication of final regulations in the **Federal Register**.

* * * * *

A-3. (a) * * *

(3) *Waiver prohibition.* In general, except as provided in paragraph (b) of this Q&A-3, a participant may not elect to waive section 411(d)(6) protected benefits. Thus, for example, the elimination of the defined benefit feature of a participant's benefit under a defined benefit plan by reason of a transfer of such benefits to a defined contribution plan pursuant to a participant election, at a time when the benefit is not distributable to the participant, violates section 411(d)(6).

(4) *Direct rollovers*. A direct rollover described in Q&A-3 of §1.401(a)(31)–1 that is paid to a qualified plan is not a transfer of assets and liabilities that must satisfy the requirements of section 414(l), and is not a transfer of benefits for purposes of applying the requirements under section 411(d)(6) and paragraph (a)(1) of this Q&A-3. Therefore, for example, if such a direct rollover is made to another qualified plan, the receiving plan is not required to provide, with respect to amounts paid to it in a direct rollover, the same optional forms of benefit that were provided under the plan that made the direct rollover. See §1.401(a)(31)–1, Q&A-14.

(b) *Elective transfers of benefits between defined contribution plans*–(1) *General rule*. A transfer of a participant's entire benefit between qualified defined contribution plans (other than a direct transfer described in section 401(a)(31)) that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if the following requirements are met:

(i) *Voluntary election*. The plan from which the benefits are transferred must provide that the transfer is conditioned upon a voluntary, fully-informed election by the participant to transfer the participant's entire benefit to the other qualified defined contribution plan. As an alternative to the transfer, the participant must be offered the opportunity to retain the participant's section 411(d)(6) protected benefits under the plan (or, if the plan is terminating, to receive any optional form of benefit for which the participant is eligible under the plan as required by section 411(d)(6)).

(ii) *Types of plans to which transfers may be made*. To the extent the benefits are transferred from a money purchase pension plan, the transferee plan must be a money purchase pension plan. To the extent the benefits being transferred are part of a qualified cash or deferred arrangement under section 401(k), the benefits must be transferred to a qualified cash or deferred arrangement under section 401(k). To the extent the benefits being transferred are part of an employee stock ownership plan as defined in section 4975(e)(7), the benefits must be transferred to another employee stock ownership plan. Benefits transferred from a profit-sharing plan other than from a qualified cash or deferred arrangement, or from a stock bonus plan other than an employee stock ownership plan, may be transferred to any type of defined contribution plan.

(iii) *Circumstances under which transfers may be made*. The transfer must be made in connection with an asset or stock acquisition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., an acquisition or disposition within the meaning of §1.410(b)–2(f)) or in connection with the participant's transfer of employment to a different job for which service does not result in additional allocations under the transferor plan.

(2) *Applicable qualification requirements*. A transfer described in this paragraph (b) is a transfer of assets or liabilities within the meaning of section 414(l)(1) that must meet the requirements of section 414(l) and all other applicable qualification requirements. Thus, for example, if the survivor annuity requirements of sections 401(a)(11) and 417 apply to the plan from which the benefits are transferred, as described in this paragraph (b), but do not otherwise apply to the receiving plan, the requirements of sections 401(a)(11) and 417 must be met with respect to the transferred benefits under the receiving plan. In addition, the vesting provisions under the receiving plan must satisfy the requirements of section 401(a)(10) with respect to the amounts transferred.

(c) *Elective transfers of certain distributable benefits between defined benefit plans or between defined contribution plans*–(1) *In general*. A transfer of a participant's benefits that are distributable between qualified defined benefit plans, or between defined contribution plans (other than the portion of such a transfer that is a direct transfer described in section 401(a)(31)), that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if–

(i) The voluntary election requirement of paragraph (b)(1)(i) of this Q&A-3 is met; and

(ii) The amount of the benefit transferred, together with the amount of a contemporaneous section 401(a)(31) transfer to the transferee plan, equals the entire nonforfeitable accrued benefit under the plan of the participant whose benefit is being transferred, calculated to be at least the greater of the single-sum distribution provided for under the plan for which the participant is eligible (if any) or the present value of the participant's accrued benefit payable at normal retirement age (calculated by using interest and mortality assumptions that satisfy the requirements of section 417(e) and subject to the limitations imposed by section 415).

(2) *Treatment of transfer*. The transfer of benefits pursuant to this paragraph (c) generally is treated as a distribution for purposes of section 401(a). For example, the transfer is subject to the cash-out rules of section 411(a)(7), the early termination requirements of section 411(d)(2), and the survivor annuity requirements of sections 401(a)(11) and 417. However, the transfer is not treated as a distribution for purposes of the minimum distribution requirements of section 401(a)(9).

(3) *Distributable benefits*. For purposes of this paragraph (c), a participant's benefits are distributable on a particular date if, on that date, the participant is eligible, under the terms of the plan from which the benefits are transferred, to receive an immediate distribution of these benefits from that plan under provisions of the plan not inconsistent with section 401(a).

(d) *Status of elective transfer as optional form of benefit*. A right to a transfer of benefits pursuant to the elective transfer rules of paragraph (b) or (c) of this Q&A-3 is an optional form of benefit under section 411(d)(6). The availability of such optional form is subject to the nondiscrimination requirements of section 401(a)(4). However, a plan will not be treated as failing to satisfy §1.401(a)(4)–4 merely because it restricts the transfer option to benefits that exceed the dollar limits on mandatory distributions that can be made without the consent of the participant under section 411(a)(11).

(e) *Effective date*. This Q&A-3 is applicable for transfers made after the date of publication of final regulations in the **Federal Register**.

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 28, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 29, 2000, 65 F.R. 16546)

Notice of Proposed Rulemaking and Notice of Public Hearing

Coordination of Sections 755 and 1060 Relating to Allocation of Basis Adjustments Among Partnership Assets

REG–107872–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the allocation of basis adjustments among partnership assets under section 755. The proposed regulations are necessary to implement section 1060(d), which applies the residual method to certain partnership transactions. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by July 4, 2000. Outlines of topics to be discussed at the public hearing scheduled for July 12, 2000, must be received by June 21, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–107872–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–107872–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/tax_regs/reglist.html. The public hearing will be held in room 2716, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Matthew Lay or Craig Gerson, (202) 622-3050; concerning submissions, the hearing, and/or to be placed on the building access list to attend the hearing, LaNita VanDyke, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

As part of the Tax Reform Act of 1986, Congress enacted section 1060, which generally requires the use of the residual method in order to allocate the purchase price of "applicable asset ac-

quisitions" among individual assets purchased. An applicable asset acquisition is defined as any transfer of assets that constitute a trade or business where the transferee's basis is determined wholly by reference to the consideration paid for the assets. Both direct and indirect transfers of a business were intended to be covered by the provision, including "the sale of a partnership interest in which the basis of the purchasing partner's proportionate share of the partnership's assets is adjusted to reflect the purchase price." See section 1060(c) and S. Rep. No. 99–313, 1986–3 C.B. Vol. 3 at 254–255.

In July of 1988, the IRS and the Treasury Department issued temporary and proposed regulations, which, among other things, provided guidance concerning the application of section 1060 and coordinated the application of sections 755 and 1060. TD 8215 (1988–2 C.B. 305).

In 1988, shortly after the IRS and the Treasury Department issued its temporary and proposed regulations, Congress enacted section 1060(d), which expressly addresses the extent to which section 1060 should apply to transactions involving partnerships. As amended in 1993, section 1060(d)(1) applies the section 1060 residual method in the case of a distribution of partnership property or a transfer of an interest in a partnership, but only in determining the value of section 197 intangibles for purposes of applying section 755. Section 1060(d)(2) provides that if section 755 applies, such distribution or transfer (as the case may be) shall be treated as an applicable asset acquisition for purposes of section 1060(b) (which imposes certain reporting requirements for applicable asset acquisitions).

Section 755 governs the allocation of certain adjustments to the basis of partnership property among partnership assets. Section 1.755–2T applies the residual method to transfers and distributions which trigger basis adjustments under section 743(b) (involving certain transfers of partnership interests) or section 732(d) (involving certain distributions within two years of a partnership interest transfer) if the assets of the partnership constitute a trade or business for purposes of section 1060(c). Section 1.755–2T(c) contains a cross reference to the reporting requirements applicable to such transfers and distributions.

Explanation of Provisions

1. Application of Proposed Regulations

The temporary regulations under section 755 apply only if the assets of the partnership comprise a trade or business within the meaning of section 1060(c), and the basis adjustments are made under section 743(b) or section 732(d). They do not apply the residual method in valuing partnership property for the purpose of allocating basis adjustments under section 734(b). However, the temporary regulations were issued prior to the enactment of section 1060(d)(1), which expressly refers to basis adjustments triggered by partnership distributions, and does not reference a trade or business requirement.

The IRS and the Treasury Department anticipate that the regulations under §1.755–2, when finalized, will apply to all transfers of partnership interests and partnership distributions to which section 755 applies, and not just to transfers and distributions relating to partnerships conducting a trade or business. This approach is consistent with the language of section 1060(d) and is supported by language contained in the legislative history. See H.R. Rep. No. 100–795, at 70 n.34 (1988) (the IRS is not precluded from applying the residual method under other provisions of the Code).

Proposed §1.755–2(d) contains a cross reference to the reporting requirements applicable to such transfers and distributions.

2. Basis Adjustments Under Section 743(b) or 732(d)

In the case of a basis adjustment under section 743(b) or section 732(d), the proposed regulations determine the fair market value of partnership assets in two steps. In most situations, it first is necessary to determine partnership gross value. Second, partnership gross value must be allocated among partnership property.

(a) Partnership gross value. In general, partnership gross value equals the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner equal to the transferee's basis in the transferred partnership interest immediately following the relevant transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities). Here, the amount paid for the partnership interest provides the frame of reference for valuing the entire partnership.

In the case of basis adjustments which are triggered by an exchange of a partnership interest in which the transferee's basis in the interest is determined in whole or in part by reference to the transferor's basis in the interest (transferred basis exchange), the transferee's basis does not necessarily have any connection to the value of partnership assets. Accordingly, a transferred basis exchange provides no frame of reference for valuing partnership assets. Furthermore, if the valuation rules which apply to other transfers were applied to transferred basis exchanges, then partners could use these exchanges to shift basis from capital gain assets to ordinary income assets, or vice versa. The proposed regulations do not provide a rule addressing transferred basis exchanges. Comments are requested as to how the residual method should apply if basis adjustments under section 743(b) are triggered by transferred basis exchanges, or if basis adjustments under section 732(d) relate to prior transferred basis exchanges.

(b) Allocating partnership gross value among partnership property. Once determined, partnership gross value is allocated among five classes of property, as follows: first among cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions (referred to hereafter as cash); then among partnership assets other than cash, capital assets, section 1231(b) property, and section 197 intangibles (referred to hereafter as ordinary income property); then among capital assets and section 1231(b) property other than section 197 intangibles; then among section 197 intangibles other than goodwill and going concern value; and finally to goodwill and going concern value (referred to hereafter as goodwill).

In determining the values to be assigned to assets in the third, fourth, and

fifth classes, properties or potential gain within these classes that are treated as unrealized receivables under the flush language in section 751(c) are not counted as assets in the second class. To provide otherwise would be inconsistent with the residual method, because the residual method is justified, at least in part, by the fact that goodwill is not readily subject to valuation. Where goodwill is subject to amortization under section 197, the portion of the intangible that is subject to recapture under section 1245 will be treated as an unrealized receivable under the flush language of section 751(c). To assign value to this portion of the asset in the second class would require a determination that the goodwill has a value equal to at least the amount of the recapture. If these assets are not readily subject to valuation, this determination presumably could not be made. Accordingly, in allocating value among the five classes under the residual method, it is appropriate to include properties or potential gain treated as unrealized receivables under the flush language of section 751(c) within the overall class to which the underlying property belongs rather than treating the section 751(c) portion of such property as a separate asset included in the second class.

Although properties or potential gain treated as unrealized receivables under the flush language of section 751(c) are not included in the second class of assets under these proposed regulations for purposes of allocating value, they are treated as separate assets that are ordinary income property for purposes of allocating basis adjustments among such assets under §1.755–1.

With respect to allocating value within the asset classes, in general, if the value assigned to a class is less than the sum of the fair market values of the assets in that class (determined without regard to the residual method), then the assigned value must be allocated among the individual assets in proportion to their fair market values. Although, as discussed above, it is not appropriate to treat properties or potential gain treated as unrealized receivables under the flush language of section 751(c) as separate ordinary income assets, it is appropriate to allocate value within each class by giving priority to the portions of the assets that will be taxed at higher rates as ordinary income. Such treatment better equates the basis adjustments of the transferee with the higher taxed income recognized by the transferor, thereby avoiding duplicative recognition of ordinary income on subsequent transfers with respect to the same asset. Accordingly, once values have been assigned generally to the third, fourth, and fifth classes of assets, such values will be assigned within each of these classes first to properties or potential gain treated as unrealized receivables under the flush language in section 751(c), if any, in proportion to the income that would be recognized if the underlying assets were sold for their fair market values (determined without regard to the residual method), but only to the extent of the income attributable to the unrealized receivables. Any remaining value in each class will be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined without regard to the residual method).

In general, the value assigned to an asset (other than goodwill) cannot exceed the fair market value (determined without regard to the residual method) of that asset on the date of the relevant transfer. Therefore, if partnership gross value exceeds the aggregate value of the partnership's individual assets, the excess must be allocated entirely to the value of goodwill. However, an exception is provided if partnership gross value exceeds the aggregate value of the partnership's individual assets, and goodwill could not under any circumstances attach to the assets. Under this exception, the excess partnership gross value must be allocated among all partnership assets other than cash in proportion to their fair market values (determined without regard to the residual method).

(c) Special situations. In general, partnership gross value may be determined without reference to the value of individual partnership assets. In calculating partnership gross value, it is only necessary to determine the relevant partner's share of book value in partnership assets and how much book gain or loss must be recognized by the partnership on the disposition of all such assets to cause the partner to receive the appropriate liquidating distribution. The manner in which the book gain or loss is allocated among the partnership's assets generally will not affect the amount of the liquidating distribution to the partner.

In certain circumstances, however, such as where book income or loss with respect to particular partnership properties is allocated differently among partners, partnership gross value may vary depending on the value of particular partnership assets. In these situations, it is not possible to first determine the total value of the partnership (i.e., partnership gross value) and then apply the residual method to allocate that value to the partnership's individual assets. Instead, it is necessary first to determine the fair market value of the partnership's individual assets (determined taking into account all relevant facts and circumstances), and then to assign such value among the asset tiers described in the residual method such that the combined value of all partnership assets would cause the appropriate distribution to the relevant partner. The proposed regulations include a rule to address these special situations. In addition, under this rule, if the value determined for assets in the first four asset classes is not sufficient to cause the appropriate liquidating distribution, then, so long as goodwill could attach to the assets of the partnership, the value of goodwill is presumed to be an amount that, if assigned to such property, would cause the appropriate liquidating distribution.

3. Basis Adjustments Under Section 734(b)

The proposed regulations do not provide a rule for valuing partnership assets in the case of distributions that result in a basis adjustment under section 734(b). The IRS and the Treasury Department have considered several alternative approaches, described below. Two of these approaches utilize a method similar to the one provided for basis adjustments under sections 743(b) and 732(d); that is, first determine partnership gross value and then allocate such amount among the partnership property applying the residual method. The third approach does not rely on the concept of partnership gross value. The IRS and the Treasury Department request comments as to which, if

any, of these approaches should be utilized in applying the residual method in the context of basis adjustments under section 734(b). In addition, comments are requested concerning whether the second or third approach should be adopted in the context of basis adjustments under sections 743(b) and 732(d) involving transferred basis transactions.

Under the first approach, in the case of a distribution which results in a basis adjustment under section 734(b) and which causes the distributee partner's interest in the partnership to decrease, partnership gross value would be deemed to equal the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner (attributable to the reduction in interest) equal to the value of the consideration received by the distributee partner in the distribution. Under this approach, the amount distributed in exchange for the relinquished interest would provide the frame of reference for valuing the entire partnership. The reduction in a partner's interest could be measured as the difference between the partner's interest in the partnership immediately before the distribution and the partner's interest in the partnership immediately after the distribution. However, the IRS and the Treasury Department recognize that measuring the reduction in a partner's interest in the partnership in connection with a distribution can be difficult in some situations (for example, situations in which partners do not share profits or other items in proportion to their relative capital account balances). Moreover, in the case of a distribution that results in a basis adjustment under section 734(b) and does not reduce the distributee partner's interest in the partnership (such as in a pro rata distribution of cash), the transaction provides no frame of reference to value the partnership.

A second approach would be to determine partnership gross value as the value of the entire partnership as a going concern, and to apply the residual method by reference to that overall value. This method has the disadvantage of divorcing the valuation of partnership property from the transaction that gives rise to the adjustment. However, there would be no need to measure the reduction in the distributee partner's interest or even to have a reduction in the distributee partner's interest to apply this method. The method would work equally well for distributions where the partner's interest in the partnership is reduced and for distributions where it is not.

Under a third possible approach, the concept of partnership gross value would be disregarded, and, instead, value would be allocated to goodwill for section 755 purposes only if the amount of a positive basis adjustment under section 734(b) exceeds the appreciation in all assets of the character required to be adjusted which are not goodwill. This approach avoids the problems relating to the measurement or presence of a reduction in the distributee partner's interest and has the added benefit of avoiding a valuation of the partnership's overall operations. In contrast with the second approach, however, the value that is assigned to goodwill under this approach would not necessarily bear any relation to the actual value of goodwill in the hands of the partnership. In addition, this rule arguably would be inconsistent with the rule in §1.755–1(c), which requires that positive basis adjustments must be allocated to undistributed property of like character to the distributed property (or capital gain property in the case of adjustments attributable to gain recognized by the distributee partner) first in proportion to unrealized appreciation with respect to such property and then in proportion to fair market value. Under the third approach, a basis adjustment under section 734(b) to the class of assets composed of capital assets and property described in section 1231(b) could not exceed the unrealized appreciation with respect to any such partnership property other than goodwill. Accordingly, a section 734(b) basis adjustment never would be made in proportion to the fair market value of the property in the class of capital assets and property described in section 1231(b).

4. Effect on §1.755–1

Section 1.755–1(b)(3)(ii)(B) of the Income Tax Regulations published on December 15, 1999 (64 FR 69903) contains a rule allocating discounts among capital assets following the transfer of a partnership interest that results in a basis adjustment under section 743(b). Because proposed §1.755–2 takes discounts and premiums into account when assigning values to partnership property for purposes of section 755 in such cases, the rule in §1.755–1(b)(3)(ii)(B) would become unnecessary.

5. Possible Expansion of Regulations

With respect to transfers of partnership interests, the IRS and the Treasury Department are considering applying the rules contained in these proposed regulations not just for valuing partnership assets for purposes of applying section 755, but also to determine the value of assets for purposes of applying section 1(h)(6)(B) (collectibles gain or loss) with respect to partnerships, section 1(h)(7) (section 1250 capital gain), and section 751(a) (ordinary income treatment upon sale or exchange of an interest in a partnership). Applying the rules in these proposed regulations in connection with these provisions is consistent with the legislative history to section 1060(d) and would provide greater uniformity with respect to the amount and character of income recognized upon the transfer of a partnership interest and the basis adjustments to partnership assets to which the different income character is attributable. However, this application of the rules could cause an increase in complexity, particularly if a section 754 election is not in effect for a year in which the transfer of a partnership interest occurs (so that application of the residual method otherwise would not be required). The IRS and the Treasury Department request comments on whether partnerships should value partnership assets using the residual method for purposes of sections 1(h)(6)(B), 1(h)(7), and 751(a).

Proposed Effective Date

The regulations are proposed to be effective for any basis adjustment resulting from any distribution of partnership property or transfer of a partnership interest that occurs on or after the date final regulations are published in the Federal Register.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Ex-

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

Comments and Public Hearing

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

A public hearing has been scheduled for July 12, 2000, beginning at 10 a.m., in room 2716 of the Internal Revenue Building. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. 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 15 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 the preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 21, 2000.

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 proposed regulations is Matthew Lay of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the IRS and the 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 a new entry in numerical order to read in part as follows:

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

Section 1.755–2 also issued under 26 U.S.C. 755 and 26 U.S.C. 1060. ***

Par. 2. Section 1.755–2 is added to read as follows:

§1.755–2 Coordination of sections 755 and 1060.

(a) *Coordination with section 1060*—(1) *In general.* If there is a basis adjustment to which this section applies, the partnership must determine the fair market value of each item of partnership property under the residual method, as described in paragraph (b) of this section, and the rules of §1.755–1 must be applied using the values so determined.

(2) *Application of this section.* This section applies to any basis adjustment made under section 743(b) (relating to certain transfers of interests in a partnership) or section 732(d) or section 734(b) (relating to certain partnership distributions).

(b) *Residual method*—(1) *In general*—(i) *Five classes.* (A) Except as provided in paragraph (b)(3) of this section, partnership gross value (as defined in paragraph (c) of this section) is allocated among five asset classes in the following order—

(*1*) Among cash and general deposit accounts (including savings and checking accounts) other than certificates of deposit held in banks, savings and loan associations, and other depository institutions (referred to hereafter as cash);

(*2*) Among partnership assets other than cash, capital assets, section 1231(b) property, and section 197 intangibles (referred to hereafter as ordinary income property);

(*3*) Among capital assets and section 1231(b) property other than section 197 intangibles;

(*4*) Among section 197 intangibles other than goodwill and going concern value; and

(*5*) To goodwill and going concern value (referred to hereafter as goodwill).

(B) In determining the values to be assigned to each class, properties or potential gain treated as unrealized receivables under the flush language in section 751(c) are not counted as assets in the second class. For example, any portion of goodwill that would result in ordinary income under section 1245 if the goodwill were sold would be included in the residual class for goodwill.

(ii) *Impaired classes.* If the value assigned to a class is less than the sum of the fair market values (determined under paragraph (b)(2)(i) of this section) of the assets in that class, then the assigned value generally must be allocated among the individual assets in proportion to such fair market values. However, in the third, fourth, and fifth classes, values must be assigned first to properties or potential gain treated as unrealized receivables under the flush language in section 751(c), if any, in proportion to the income that would be recognized if the underlying assets were sold for their fair market values (determined under paragraph (b)(2)(i) of this section), but only to the extent of the income attributable to the unrealized receivables. Any remaining value in each class will be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined under paragraph (b)(2)(i) of this section).

(2) *Special rules.* For purposes of this section:

(i) Except as otherwise provided in this section, the fair market value of each item of partnership property (other than goodwill) shall be determined on the basis of all the facts and circumstances, taking into account section 7701(g).

(ii) If goodwill could not under any circumstances attach to the assets of a partnership, then the value of goodwill is zero. This might occur, for example, if a partnership's only asset is a vacant parcel of real estate that does not produce current income.

(iii) (A) The value assigned to an asset (other than goodwill) shall not exceed the fair market value (determined under paragraph (b)(2)(i)) of that asset on the date of the relevant transfer, unless—

(*1*) Partnership gross value (as defined in paragraph (c) of this section) exceeds the aggregate value of the partnership's individual assets; and

(*2*) Goodwill could not under any circumstances attach to the assets.

(B) If both of these conditions are satisfied, the excess must be allocated among all partnership assets other than cash in proportion to such fair market values.

(3) *Special situations*. In certain circumstances, such as where book income or loss with respect to particular partnership properties is allocated differently among partners, partnership gross value may vary depending on the value of particular partnership assets. In these special situations, the fair market value of each item of partnership property (other than goodwill) first shall be determined on the basis of all the facts and circumstances, taking into account section 7701(g). Such value then shall be assigned within the first four asset classes under the residual method described in paragraph (b)(1) of this section in a manner that is consistent with the ordering rule used in paragraph (b)(1) of this section (together with the special rules in paragraph (b)(2) of this section) so that the amount of the liquidating distribution described in paragraph (c)(1) of this section would equal the transferee's basis in the transferred partnership interest. If the value so determined for the assets in the first four asset classes is not sufficient to cause the appropriate liquidating distribution, then, so long as goodwill may attach to the assets of the partnership, the fair market value of goodwill shall be presumed to equal an amount that if assigned to goodwill would cause the appropriate liquidating distribution.

(c) *Partnership gross value*—(1) *Basis adjustments under section 743(b) and section 732(d)*—(i) *In general*. In the case of a basis adjustment under section 743(b) or 732(d), partnership gross value generally is equal to the amount that, if assigned to all partnership property, would result in a liquidating distribution to the partner equal to the transferee's basis in the transferred partnership interest immediately following the relevant transfer (reduced by the amount, if any, of such basis that is attributable to partnership liabilities) pursuant to the hypothetical transaction (as defined in paragraph (c)(3) of this section). Solely for the purpose of determining partnership gross value under the preceding sentence, where a partnership interest is transferred as a result of the death of a partner, the transferee's basis in its partnership interest is determined without regard to section 1014(c), and is deemed to be adjusted for that portion of the interest, if any, which is attributable to items representing income in respect of a decedent under section 691.

(ii) *Transferred basis transactions*. [Reserved]

(2) *Basis adjustments under section 734(b)*. [Reserved]

(3) *Hypothetical transaction*. For purposes of this paragraph (c), the hypothetical transaction means the disposition by the partnership of all partnership property in a fully taxable transaction for cash, followed by the payment of all partnership liabilities (within the meaning of section 752 and the regulations thereunder), and the distribution of all remaining proceeds to the partners.

(d) *Required statements*. See §1.743–1(k)(2) for provisions requiring the transferee of a partnership interest to provide information to the partnership relating to the transfer of an interest in the partnership. See §1.743–1(k)(1) for a provision requiring the partnership to attach a statement to the partnership return showing the computation of a basis adjustment under section 743(b) and the partnership properties to which the adjustment is allocated under section 755. See §1.732–1(d)(3) for a provision requiring a transferee partner to attach a statement to its return showing the computation of a basis adjustment under section 732(d) and the partnership properties to which the adjustment is allocated under section 755. See §1.732–1(d)(5) for a provision requiring the partnership to provide information to a transferee partner reporting a basis adjustment under section 732(d).

(e) *Examples*. The provisions of this section are illustrated by the following examples, which assume that the partnerships have an election in effect under section 754 at the time of the transfer. Except as provided, no partnership asset (other than inventory) is property described in section 751(a). The examples are as follows:

Example 1. (i) A is the sole general partner in ABC, a limited partnership. ABC has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000, a building (a capital asset) worth $2,000,000, and section 197 intangibles (other than goodwill) worth $800,000. ABC has one liability of $1,000,000, for which A bears the entire risk of loss under section 752 and the regulations thereunder. Each partner has a one-third interest in partnership capital and profits. D purchases A's partnership interest for $1,000,000.

(ii) D's basis in the transferred partnership interest (reduced by the amount of such basis that is attributable to partnership liabilities) is $1,000,000 ($2,000,000 - $1,000,000). Under paragraph (c) of this section, partnership gross value is $4,000,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to D equal to $1,000,000).

(iii) Under paragraph (b) of this section, partnership gross value is allocated first to the inventory ($1,000,000), then to the building ($2,000,000), and third to section 197 intangibles $800,000. The partnership must allocate the remainder of partnership gross value, $200,000, to goodwill ($4,000,000 - $3,800,000). D's section 743(b) adjustment must be allocated under §1.755-1 using these fair market value calculations for the partnership's assets.

Example 2. (i) D is the sole general partner in DEF, a limited partnership. DEF has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000, a building (a capital asset) worth $2,000,000, and equipment (section 1231(b) property) worth $750,000. DEF has one liability of $1,000,000, for which D bears the entire risk of loss under section 752 and the regulations thereunder. Each partner has a one-third interest in partnership capital and profits. If the equipment were sold for $750,000, $250,000 would be depreciation recapture treated as an unrealized receivable under the flush language in section 751(c). G purchases E's limited partnership interest for $750,000.

(ii) Under paragraph (c) of this section, partnership gross value is $3,250,000 (the amount that, if assigned to all partnership property, would result in a liquidating distribution to G equal to $750,000).

(iii) Under paragraph (b) of this section, partnership gross value is allocated first to inventory ($1,000,000), and then to the class containing capital assets and section 1231(b) property

($2,250,000). Within that class, value must be assigned first to the $250,000 ordinary gain portion of the equipment (properties or potential gain treated as unrealized receivables under the flush language in section 751(c)). The remaining value in the class ($2,250,000 minus $250,000, which is $2,000,000) must be allocated among the remaining portions of the assets in that class in proportion to the fair market values of such portions (determined under paragraph (b)(2)(i) of this section). The remaining portion of the building is $2,000,000. The remaining portion of the equipment is $500,000 ($750,000, its fair market value, minus $250,000, the section 751(c) portion). Thus, the remaining portion of the building will be allocated $1,600,000 ($2,000,000 multiplied by $2,000,000/$2,500,000) and the remaining portion of the equipment will be allocated $400,000 ($2,000,000 multiplied by $500,000/$2,500,000). Nothing is allocated to goodwill. G's section 743(b) adjustment must be allocated under §1.755–1 using these fair market value calculations for the partnership's assets.

Example 3. (i) G and H are partners in partnership GH. GH has goodwill and three other assets with fair market values (determined under paragraph (b)(2)(i) of this section) as follows: inventory worth $1,000,000 and two buildings (capital assets), each worth $500,000. GH has no liabilities. The GH partnership agreement provides that the partners will allocate all income, gain, loss, and deductions equally, except with respect to depreciation, loss, and gain from the buildings. With respect to the buildings, depreciation and loss are allocated two-thirds to G and one-third to H. Gain from the disposition of the buildings is charged back two-thirds to G and one-third to H to the extent of accrued depreciation, and then is allocated equally between G and H. G transfers one-half of its interest in GH to I for $450,000. At the time of the transfer, the book value of the inventory is $900,000, the book value of each building is $300,000, and $150,000 of book depreciation has accrued with respect to each building. The capital account attributable to the partnership interest purchased by I from G is equal to $350,000. H's capital account is equal to $800,000, and the capital account attributable to G's retained partnership interest is equal to $350,000.

(ii) Because gain with respect to the inventory and buildings are shared in different ratios as between H, and G and I, a partnership gross value cannot be determined without assuming values for the individual assets of the partnership. Accordingly, the rule for special situations in paragraph (b)(3) of this section must be used to compute the value of the partnership's assets.

(iii) Applying paragraph (b)(2)(i) of this section, the fair market value of the inventory is $1,000,000 and the fair market value of each building is $500,000. These values would result in a liquidating distribution to I under paragraph (c)(1) of this section equal to $500,000, determined as follows. The book gain from the sale of the inventory would equal $100,000 ($1,000,000 - $900,000) and the book gain from the sale of each building would equal $200,000 ($500,000 - $300,000). Book gain from the inventory equal to $25,000 ($100,000 x 1/4) and book gain from each building equal to $62,500 (($150,000 x 1/3) + ($50,000 x 1/4)) would be allocated to I. The sum of this book gain ($25,000 + $62,500 + $62,500 = $150,000) and I's capital account inherited from G ($350,000) would equal $500,000.

(iv) Because I's basis in the transferred partnership interest is only $450,000, under paragraph (b)(2)(ii) of this section, the value with respect to the buildings must be reduced in proportion to the fair market values of such assets to an amount that would cause a liquidating distribution to I equal to $450,000. This calculation is accomplished as follows. In order for I to receive a liquidating distribution of $450,000, the book gain attributable to the buildings that is allocated to I must equal $75,000 ($350,000 inherited capital account + $25,000 book gain from inventory + $75,000 book gain from buildings). Each building has the same book value and fair market value, and the allocations with respect to each building are the same as between G, H, and I. Accordingly, I's share of book gain should be allocated equally between the two buildings, $37,500 to each. In order for I to be allocated $37,500 of book gain with respect to each building, the total amount of book gain with respect to each building would have to be $112,500 ($112,500 x 1/3 = $37,500). Adding this book gain to the current book value of each building results in a value for each building of $412,500 ($300,000 + $112,500). Nothing is allocated to goodwill. I's section 743(b) adjustment must be allocated under §1.755–1 using these fair market value calculations for the partnership's assets.

Example 4. The facts are the same as *Example 3*, except that I purchases one-half of G's partnership interest for $550,000. Because the fair market value of the partnership's assets (as determined under paragraph (b)(2)(i) of this section) in the first four asset classes under the residual method is not sufficient to cause a liquidating distribution to I equal to its basis in the purchased interest (i.e., $550,000), the additional value necessary to cause such a distribution must be allocated to goodwill. Accordingly, under paragraph (b)(3) of this section, the value of the partnership's assets is as follows: inventory $1,000,000, each building $500,000, and goodwill $200,000. I's section 743(b) adjustment must be allocated under §1.755-1 using these fair market value calculations for the partnership's assets.

(f) *Effective date*. This section applies to any basis adjustment resulting from any distribution of partnership property or transfer of a partnership interest that occurs on or after the date final regulations are published in the **Federal Register**.

§1.755–2T [Removed]

Par. 3. Section 1.755–2T is removed.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 4, 2000, 8:45 a.m., and published in the issue of the Federal Register for April 5, 2000, 65 F.R. 17829)

Notice of Proposed Rulemaking and Notice of Public Hearing

Lifetime Charitable Lead Trusts

REG–100291–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: These proposed regulations relate to the definitions of a guaranteed annuity interest and a unitrust interest for purposes of the income, gift, and estate tax charitable deductions. The proposed regulations will affect taxpayers who make transfers to charitable lead trusts. The purpose of these proposed regulations is to restrict the permissible terms for charitable lead trusts in order to eliminate the potential for abuse. This document also provides notice of a public hearing.

DATES: Written and electronic comments must be received by June 19, 2000. Outlines of topics to be discussed at the public hearing scheduled for June 29, 2000, must be received by June 8, 2000.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–100291–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may also be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–100291–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html. The public hearing will be held in room 4718, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Scott S. Landes, (202) 622-3090; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy

R. Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

In general, if interests in the same property are transferred for both charitable and noncharitable purposes, the charitable interest will qualify for the charitable deduction for federal income, gift, and estate tax purposes only if the interest is in one of certain prescribed forms. If the charitable interest is not a remainder interest, sections 170, 2522, and 2055 of the Internal Revenue Code (Code) require that the charitable interest be in the form of either a guaranteed annuity interest or a fixed percentage of the annual fair market value of the property (unitrust interest). In addition, an income tax charitable deduction is available only if the grantor is treated as the owner of the entire trust under subpart E, part I of subchapter J of the Code.

The requirement that a nonremainder interest passing to charity be in the form of a guaranteed annuity interest or a unitrust interest was added to the Code by the Tax Reform Act of 1969. That Act also added the requirement that a remainder interest passing to charity must generally be in the form of a charitable remainder unitrust or annuity trust or a pooled income fund. The statutory provisions for charitable remainder trusts and pooled income funds specifically state the permissible terms for these entities. Section 664(d)(1)(A) and (d)(2)(A) provide that the permissible term for a charitable remainder trust is a period of years (not to exceed 20 years) or the life or lives of individuals who are living at the creation of the trust. Similarly, section 642(c)(5)(A) provides that the permissible term for the noncharitable income interest in a pooled income fund is the life of one or more beneficiaries living at the time of the transfer.

Unlike the statutory provisions for charitable remainder trusts and pooled income funds, neither the statute nor the legislative history sets forth the permissible term for which a charitable guaranteed annuity interest or a unitrust interest must be paid. Rather, the permissible term for these interests is set forth in the regulations as either a specified term of years, or the life or lives of an individual or individuals, each of whom must be living at the date of the transfer and can be ascertained at such date.

The IRS and the Treasury Department are aware of situations in which taxpayers attempt to take advantage of the regulations by using an unrelated individual's measuring life, as the term of a charitable lead trust, to artificially inflate the charitable deduction. Taxpayers select as a measuring life an individual who is seriously ill but not "terminally ill" within the meaning of the section 7520 regulations. Because the individual is not "terminally ill" as defined in the regulations, the charitable interest is valued based on the actuarial tables. These tables take into account the life expectancies of all individuals of the same age as the individual who is the measuring life, even though such individual has been carefully chosen because he or she likely will not live to an average life expectancy. When the seriously ill individual dies prematurely, the amount the charity actually receives will be significantly less than the amount on which the gift or estate tax charitable deduction was based. Conversely, the amount of the actual transfer to the remainder beneficiaries will be significantly greater than the amount subject to gift or estate tax.

These charitable lead trusts are being marketed in a package which includes the name of a seriously ill individual and access to the individual's medical records. A token payment is made to the ill individual who is serving as a measuring life. Sometimes the individual is led to believe that a charitable organization interested in the individual's particular illness will receive some benefit from the transaction. In the words of one author, "[t]his technique (which is not strictly speaking wealth transfer planning for the terminally ill, but rather wealth transfer planning *using* the terminally ill) falls somewhere between ghoulish and grotesque." Marketing schemes that exploit the misfortunes of some for the benefit of others are contrary to public policy.

The IRS and the Treasury Department believe that this scheme is abusive and frustrates the Congressional purpose in limiting the charitable deduction to specific types of split-interest transfers. Congress enacted the provisions regarding guaranteed annuity interests, unitrust interests, charitable remainder trusts, and pooled income funds in order to ensure that the amount the taxpayer claims as a charitable deduction reasonably correlates to the amount ultimately passing to the charitable organization. H.R. Rep. No. 413 (Part 1), 91st Cong., 1st Sess. 61 (1969); S. Rep. No. 552, 91st Cong., 1st Sess. 93 (1969). In this scheme, taxpayers choose a measuring life that ensures the amount passing to charity will be substantially less than the allowable charitable deduction. This kind of adverse selection of an unrelated measuring life to artificially inflate the charitable deduction is contrary to Congressional intent.

EXPLANATION OF PROVISIONS

Under the proposed regulations, the permissible term for guaranteed annuity interests and unitrust interests is either a specified term of years, or the life of certain individuals living at the date of the transfer. Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable guaranteed annuity interest or unitrust interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a guaranteed annuity or unitrust interest even if the governing instrument contains a "savings clause" intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. For example, a guaranteed annuity or unitrust interest that will terminate on the earlier of 30 years or 21 years after the death of the last survivor of the descendants of any grandparent of the donor living on the date of the creation of the interest will be treated as payable for a specified term of years.

The proposed regulations will allow the use of an individual's measuring life when appropriate for estate planning purposes. Thus, the regulations permit the donor, the donor's spouse, or an individual who is an ancestor of the remainder

beneficiaries to be used as the measuring life. A transfer using the donor or the donor's spouse as the measuring life is a substitute for a testamentary disposition to the remainder beneficiaries. In other situations, the donor may desire to benefit an individual's heirs only after the death of the individual currently providing their support. For example, a donor may establish a charitable lead trust for the life of the donor's sibling with the sibling's children named as the remainder beneficiaries. A measuring life unrelated to the remainder beneficiaries is not appropriate for estate planning purposes and therefore is not permitted under the proposed regulations.

The proposed regulations apply to transfers to inter vivos charitable lead trusts made on or after April 4, 2000. In addition, the proposed regulations apply to transfers made pursuant to wills or revocable trusts where the decedent dies on or after April 4, 2000. Two exceptions from the application of the proposed regulations are provided in the case of transfers pursuant to a will or revocable trust executed on or before April 4, 2000. One exception is for a decedent who dies on or before the date that is 6 months after the date these regulations are published as final regulations without having republished the will (or amended the trust) by codicil or otherwise. The other exception is for a decedent who was on April 4, 2000, under a mental disability to change the disposition of the decedent's property, and either does not regain competence to dispose of such property before the date of death, or dies prior to the later of: 90 days after the date on which the decedent first regains competence, or 6 months after the date these regulations are published as final regulations without having republished the will (or amended the trust) by codicil or otherwise.

The IRS will not disallow the charitable deduction where the charitable interest is payable for the life of an individual, other than one permitted under the proposed regulations, if the interest is reformed into a lead interest payable for a specified term of years. The term of years must be determined by taking the factor for valuing the annuity or unitrust interest for the named individual's measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. In the case of inter vivos transfers, a judicial reformation must be commenced prior to the later of: (1) the date that is 6 months after the date these regulations are published as final regulations; or (2) October 15th of the year following the year in which the transfer is made. In the case of testamentary transfers, a judicial reformation must be commenced prior to the later of: (1) the date that is 6 months after the date these regulations are published as final regulations; or (2) the date prescribed by section 2055(e)(3)(C)(iii). Any judicial reformation must be completed within a reasonable time after it is commenced. A nonjudicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced.

An alternative to reformation may be available for any transfer made on or after April 4, 2000 and on or before the date that is 60 days after the date these regulations are published as final regulations. If a court, in a proceeding that is commenced on or before 6 months after these regulations are published as final regulations, declares the transfer null and void ab initio, the Service will treat such transfer in a manner similar to that described in section 2055(e)(3)(J).

Special Analyses

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

Comments and Public Hearing

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

A public hearing has been scheduled for June 29, 2000, at 10 a.m., room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. 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 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit comments by June 19, 2000, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by June 8, 2000.

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 dead-

line for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these proposed regulations is Scott S. Landes, Office of the Chief Counsel, IRS. Other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1, 20, and 25 are proposed to be amended as follows:

PART 1 — INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * * Section 1.170A–6 also issued under 26 U.S.C. 170(f)(4); 26 U.S.C. 642(c)(5). * * *

Par. 2. Section 1.170A–6 is amended as follows:

1. Paragraph (c)(2)(i)(A) is amended as follows:

a. In the first sentence, the comma is removed.

b. In the second sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

c. The third sentence is removed, and four new sentences are added in its place.

d. In the sentence beginning "For example, the amount", the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(ii)(A) is amended as follows:

a. In the fifth sentence, the language "of years" is added after the word "term", "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The last sentence is removed, and four new sentences are added in its place.

3. Paragraph (e) is amended by adding four sentences to the end of the paragraph.

4. The authority citation at the end of the section is removed.

The additions read as follows:

§1.170A–6 Charitable contributions in trust.

* * * * *

(c) * * *

(2) * * *

(i) * * * (A) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. * * *

* * * * *

(ii) * * * (A) * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust.

* * * * *

(e) *Effective date*. * * * In addition, the rule in paragraphs (c)(2)(i)(A) and (ii)(A) of this section that guaranteed annuity interests and unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals, applies to transfers made on or after April 4, 2000. If a transfer is made to a trust on or after April 4, 2000 that uses an individual other than one permitted in paragraphs (c)(2)(i)(A) and (ii)(A) of this section, the trust may be reformed to satisfy this rule. As an alternative to reformation, rescission may be available for a transfer made on or before the date that is 60 days after the date these regulations are published as final regulations. See § 25.2522(c)–3(e) of this chapter for the requirements concerning reformation or possible rescission of these interests.

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Par. 3. The authority citation for part 20 continues to read in part as follows:

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

Par. 4. Section 20.2055–2 is amended as follows:

1. Paragraph (e)(2)(vi)*(a)* is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and four new sentences are added in its place.

c. In the sentence beginning "For example, the amount", the language "of years" is added after the word "term", the language "an individual" is removed, and "the decedent's spouse" is added in its place.

2. Paragraph (e)(2)(vii)*(a)* is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "of an individual or individuals" is removed, and "of certain individuals" is added in its place.

b. The last sentence is removed, and four new sentences are added in its place.

3. Paragraph (e)(3) is amended as follows:

a. The period at the end of paragraph (e)(3)(ii)*(c)* is removed, a comma is added and the word "and" is added after the comma.

b. A new paragraph (e)(3)(iii) is added.

The additions read as follows:

§ 20.2055–2 Transfers not exclusively for charitable purposes.

* * * * *

(e) * * *

(2) * * *

(vi) * * * *(a)* * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. * * *

* * * * *

(vii) * * * *(a)* * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust.

* * * * *

(3) * * *

(iii) The rule in paragraphs (e)(2)(vi)*(a)* and (vii)*(a)* of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals, is generally effective in the case of transfers pursuant to wills and revocable trusts where the decedent dies on or after April 4, 2000. Two exceptions from the application of the rule in paragraphs (e)(2)(vi)*(a)* and (vii)*(a)* of this section are provided in the case of transfers pursuant to a will or revocable trust executed on or before April 4, 2000. One exception is for a decedent who dies on or before the date that is 6 months after the date these regulations are published as final regulations without having republished the will (or amended the trust) by codicil or otherwise. The other exception is for a decedent who was on April 4, 2000, under a mental disability to change the disposition of the decedent's property, and either does not regain competence to dispose of such property before the date of death, or dies prior to the later of: 90 days after the date on which the decedent first regains competence, or 6 months after the date these regulations are published as final regulations without having republished the will (or amended the trust) by codicil or otherwise. If a guaranteed annuity interest or unitrust interest created pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, uses an individual other than one permitted in paragraphs (e)(2)(vi)(a) and (vii)*(a)* of this section, and the interest does not qualify for this transitional relief, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to the later of the date that is 6 months after the date these regulations are published as final regulations, or the date prescribed by section 2055(e)(3)(C)(iii). Any judicial reformation must be completed within a reasonable time after it is commenced. A non-judicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before 6 months after these regulations are published as final regulations, declares any transfer made pursuant to a will or revocable trust where the decedent dies on or after April 4, 2000, and on or before the date that is 60 days after the date these regulations are published as final regulations, null and void ab initio, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

* * * * *

PART 25 — GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 continues to read in part as follows:

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

Par. 6. Section 25.2522(c)–3 is amended as follows:

1. Paragraph (c)(2)(vi)*(a)* is amended as follows:

a. In the third sentence, the language "of years" is added after the word "term", the language "a named individual or individuals" is removed, and "certain individuals" is added in its place.

b. The fourth sentence is removed, and four new sentences are added in its place.

c. In the sentence beginning "For example, the amount", the language "of years" is added after the word "term", the language "an individual" is removed, and "the donor" is added in its place.

2. Paragraph (c)(2)(vii)*(a)* is amended as follows:

a. In the sixth sentence, the language "of years" is added after the word "term", the language "an individual or individuals" is removed, and "certain individuals" is added in its place.

b. The last sentence is removed, and four new sentences are added in its place.

3. Paragraph (e) is amended by adding nine new sentences to the end of the paragraph.

The additions read as follows:

§ 25.2522(c)–3 Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

* * * * *

(c) * * *

(2) * * *

(vi) * * * *(a)* * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable guaranteed annuity interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a guaranteed annuity interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust. * * *

* * * * *

(vii) * * * *(a)* * * * Only one or more of the following individuals may be used as measuring lives: the donor, the donor's spouse, and a lineal ancestor of all the remainder beneficiaries. However, this limitation regarding permissible measuring lives does not apply in the case of a charitable unitrust interest payable under a charitable remainder trust described in section 664. An interest payable for a specified term of years can qualify as a unitrust interest even if the governing instrument contains a savings clause intended to ensure compliance with a rule against perpetuities. The savings clause must utilize a period for vesting of 21 years after the deaths of measuring lives who are selected to maximize, rather than limit, the term of the trust.

* * * * *

(e) *Effective date.* * * * In addition, the rule in paragraphs (c)(2)(vi)*(a)* and (vii)*(a)* of this section that guaranteed annuity interests or unitrust interests, respectively, may be payable for a specified term of years or for the life or lives of only certain individuals, applies to transfers made on or after April 4, 2000. If a transfer is made on or after April 4, 2000, that uses an individual other than one permitted in paragraphs (c)(2)(vi)*(a)* and (vii)*(a)* of this section, the interest may be reformed into a lead interest payable for a specified term of years. The term of years is determined by taking the factor for valuing the annuity or unitrust interest for the named individual measuring life and identifying the term of years (rounded up to the next whole year) that corresponds to the equivalent term of years factor for an annuity or unitrust interest. For example, in the case of an annuity interest payable for the life of an individual age 40 at the time of the transfer, assuming an interest rate of 7.4% under section 7520, the annuity factor from column 1 of Table S(7.4), contained in IRS Publication 1457, Book Aleph, for the life of an individual age 40 is 12.0587 (Publication 1457 is available from the Superintendent of Documents, U.S. Government Printing Office, Washington, DC 20402). Based on Table B(7.4), contained in Publication 1457, Book Aleph, the factor 12.0587 corresponds to a term of years between 31 and 32 years. Accordingly, the annuity interest must be reformed into an interest payable for a term of 32 years. A judicial reformation must be commenced prior to the later of the date that is 6 months after the date these regulations are published as final regulations, or October 15th of the year following the year in which the transfer is made and must be completed within a reasonable time after it is commenced. A nonjudicial reformation is permitted if effective under state law, provided it is completed by the date on which a judicial reformation must be commenced. In the alternative, if a court, in a proceeding that is commenced on or before 6 months after these regulations are published as final regulations, declares any transfer, made on or after April 4, 2000, and on or before the date that is 60 days after the date these regulations are published as final regulations, null and void ab initio, the Internal Revenue Service will treat such transfers in a manner similar to that described in section 2055(e)(3)(J).

Charles O. Rossotti,
Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on April 4, 2000, 8:45 a.m., and published in the issue of the Federal Register for April 5, 2000, 65 F.R. 17835)

Advance Pricing Agreements, Issued Pursuant to Pub. L. 106-170, Section 521(b)

Announcement 2000–35

This Announcement is issued pursuant to Section 521(b) of Pub. L. 106-170, the Ticket to Work and Work Incentives Improvement Act of 1999, requiring that the Secretary of the Treasury annually report to the public concerning Advance Pricing Agreements ("APAs") and the APA Program. As this is the first report issued under Section 521(b), it includes information about APAs and the APA Program with respect to calendar years 1991 through 1999. Section 521(b)(4) . This document does not provide general guidance regarding the application of the arm's length standard; rather, it reports on the structure and activities of the APA Program.

Karl L. Kellar,
Acting Director,
Advance Pricing
Agreement Program.

ANNUAL REPORT CONCERNING ADVANCE PRICING AGREEMENTS

INTRODUCTION

For convenient reference, the subject matter of this report will be organized on the basis of Section 521(b)(2) of Pub. L. 106-170, with each required item or subject reported and captioned by reference to the corresponding statutory provision. First, however, the report provides a general introductory discussion concerning the history, practice, and general approach of the APA Program. This introductory discussion is adapted in part from material contained in Publication 3216, *Report on the Application and Administration of Section 482* (April 21, 1999).

Background

The Advance Pricing Agreement Program is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional adversarial process. Under the adversarial model, the data gathering, development, and interpretation of a transfer pricing issue is a complex, time-consuming process that often results in an administrative appeal, litigation, or competent authority proceedings under the mutual agreement procedures of our bilateral income tax treaties. A significant transfer pricing issue can typically take eight or more years to resolve. Accordingly, by the time the issue is resolved, the facts in dispute

are typically many years old, and considerable uncertainty concerning the proper transfer pricing of current transactions under current conditions can remain.

During the 1980s and prior to the creation of the APA Program, the government as well as taxpayers with transfer pricing issues began to explore some sort of an advance pricing agreement mechanism. A 1985 study by a U.S. professional group on how to improve the large case program recommended advance rulings in the transfer pricing area. In 1986, an agenda topic at a meeting of U.S. and foreign tax officials on how to reduce controversies discussed an advance resolution process for transfer pricing. In 1989, several taxpayers and groups approached the IRS to consider alternative approaches to transfer pricing compliance, viewing the existing means of dealing with transfer pricing issues as being too adversarial as well as unproductive.

The IRS considered new techniques whereby all parties could share the responsibility for enhancing compliance in the transfer pricing area. Derived from the "Compliance 2000" initiatives, this concept of shared responsibility is also consistent with the current mission statement of the IRS to work with taxpayers "to help them understand and meet their tax responsibilities." In April of 1989, the IRS announced at a meeting with the Tax Executives Institute that it was considering an advance ruling procedure for transfer pricing issues. The IRS entered into pilot projects with several taxpayers to negotiate and execute what were initially called Advance Determination Rulings but later became known as Advance Pricing Agreements (APAs). In June of 1990, a draft IRS Revenue Procedure for Advance Determination Rulings was publicly disseminated and the first APA was concluded in January of 1991. With the publication of Rev. Proc. 91–22 (1991–1 C.B. 526), in March of 1991, the IRS formally initiated the APA Program, and by the end of that year, 15 new negotiations had started.

Since then, the APA Program's caseload has steadily grown. The staff has also grown, though not at the same rate as the workload. As of December 31, 1999, the APA Program's staffing included slots for a Director, two Branch Chiefs, four Economists, fourteen Team Leaders, and three clerical support staff. As of December 31, 1999, 231 APAs had been concluded, with another 187 pending. These APAs involve a wide variety of industries. The cross-border transactions involved are also varied, including, for example, manufacturing, sale, and distribution of goods, provision of financial services, and licensing of intellectual property.

The APA Program has also become more "institutionalized" over the years. In 1996, the Service issued internal procedures for processing APA cases. Chief Counsel Directives Manual ("CCDM"), ¶¶ (42)(10)10 – (42)(10)(16)0 (November 15, 1996). Also in 1996, Rev. Proc. 96–53, 1996–2 C.B. 375, was released, updating Rev. Proc. 91–22 in light of the Service's additional experience with administering the APA Program. Together, these releases clarified APA procedures and the respective roles of the various IRS functions involved in the APA process. Rev. Proc. 96–53, in particular, also provides taxpayers a road map of how to apply for an APA and what to expect in the processing of the case.

The APA Program has had a consistent goal of making APAs more practical and affordable, and available to more taxpayers. To this end, in 1997, the IRS instituted an Early Referral program by which, in appropriate cases, District examination teams suggest that taxpayers pursue APAs before substantial time is spent examining transfer pricing issues. To date, however, only three APA requests have been filed pursuant to this procedure. Similarly, in 1998, the IRS published more streamlined procedures for APAs involving Small Business Taxpayers, and also expanded the availability of the lowest APA user fee, in an effort to attract smaller taxpayers who may lack the resources to do the sophisticated studies normally included in APA requests (Notice 98–65, 1998–52 I.R.B. 10). By the end of calendar year 1999, the IRS had concluded 9 small business APAs under these streamlined procedures.

As the United States has become more comfortable with the APA process so has the world. Today, APAs are receiving increased acceptance by many of our treaty partners, including Australia, Mexico, the United Kingdom, Japan, and Canada. In fact, of the 231 closed APAs, 118 involve our treaty partners through the bilateral process (the bilateral process is discussed below). In 1999, the Organization for Economic Cooperation and Development ("OECD") issued as an annex to its Transfer Pricing Guidelines, guidelines for bilateral APAs. OECD, *Guidelines for Conducting Advance Pricing Arrangements Under the Mutual Agreement Procedure ("MAP APAs")* (October 1999). These new OECD guidelines should lead to an even broader acceptance of the APA process by the international community, and it is to be hoped that they will expedite the processing of bilateral APAs by providing for more standardized bilateral APA procedures among OECD members.

The APA Process

The APA process is designed to enable taxpayers and the IRS to agree on the proper treatment of transfer pricing, including cost-sharing arrangements. An APA is a legally enforceable agreement. It need not cover all of a taxpayer's pricing arrangements and instead may be restricted to specified years, specified affiliates, and specified intercompany transactions. APAs are either "unilateral" or "bilateral." A unilateral APA is an agreement between only the taxpayer and the IRS on an appropriate transfer pricing methodology ("TPM") for the transactions at issue. A bilateral APA combines an agreement between the taxpayer and the IRS on a particular TPM with an agreement between the U.S. and foreign taxing authority that the TPM is correct, under authority of the mutual agreement process usually contained in Article 25 of our income tax treaties. 118 of the APAs completed as of the end of 1999 have been bilateral or multilateral, 112 unilateral, and one has involved a U.S. possession. The TPM adopted in both unilateral and bilateral APAs may also be "rolled back" to resolve similar issues for past years under examination.

In practice, an APA is always the result of a voluntary decision by a taxpayer to seek an APA. Before making any commitments or filing the formal application, Taxpayers may through a prefiling conference approach the Service to discuss the Service's preliminary views of their potential APA request, including whether an APA would be appropriate under the facts, what types of information would be necessary to support the request, and

whether the taxpayer's proposed TPM would be acceptable. Most taxpayers that come into the APA Program choose to participate in such a prefiling conference. A taxpayer may attend the prefiling conference on an anonymous basis if it wishes. Once the taxpayer decides to apply for an APA, it must prepare and file a submission consistent with the requirements of section 5 of Rev. Proc. 96–53 (1996–2 C.B. 375), accompanied by the appropriate user fee as determined under section 5.14 of Rev. Proc. 96–53.

A multidisciplinary APA Team evaluates the Taxpayer's submission. The APA process focuses on identifying an appropriate TPM, not a desired tax result. The ultimate goal of the APA process is to arrive at an agreement on three basic points: (i) the description of the intercompany transactions to which the APA applies; (ii) the TPM to be applied to those transactions; and (iii) the arm's length range of results that is expected after applying the agreed-upon TPM to the covered transactions. In effect, the IRS APA team conducts "due diligence" to verify the facts and to determine whether the proposed TPM constitutes the "best method" under the Regulations. Typically, one or more meetings between the taxpayer's representatives and the IRS APA team take place. At these meetings, the parties discuss the issues related to the case and attempt to arrive at an agreement concerning the appropriate facts, TPM, and results. In a bilateral case, the APA team will then formulate a negotiating position for use by the United States Competent Authority in negotiations with the relevant foreign government under the mutual agreement article of the applicable treaty. Once a mutual agreement under the treaty is reached, the APA team and the taxpayer will finalize an APA consistent with the terms of the agreement. In unilateral cases, the team will negotiate the terms of the APA with the taxpayer. Both the negotiating position and the APA itself are subject to review and approval by the Associate Chief Counsel (International).

The Arm's-Length Standard

Section 482 of the Internal Revenue Code permits the IRS to allocate items of income, deductions, credits, or allowances between controlled groups or organizations, "to prevent evasion of taxes, or clearly to reflect the income" of any controlled taxpayer, and, in the case of transfers of intangible property, to allocate income with respect to the transfer in a manner that is "commensurate with the income attributable to the intangible."

In determining whether an allocation under Section 482 is necessary clearly to reflect a controlled taxpayer's income, the IRS employs the "arm's length" standard, a principle which is defined in the attendant Treasury regulations. A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances. Under current Treasury regulations, the IRS is willing to consider many different approaches to establish the taxpayer's appropriate intercompany transfer pricing methodology or cost sharing practices, provided these approaches satisfy the arm's length principle.

The APA Program evaluates each APA case in terms of developing an arm's-length transfer pricing methodology that is consistent with the Regulations. Because transfer pricing cases typically involve complex facts and difficult issues, there is room for disagreement between reasonable people, acting in good faith, about both the "best method" and the proper application thereof. Therefore, in evaluating and processing an APA case, APA Program Team Leaders are willing to consider taxpayer positions, to engage in negotiations, and to work to reach a mutually acceptable understanding of the appropriate application of the arm's length standard to the taxpayer's facts, in a manner that is consistent with the Regulations.

The arm's length approach is also applied for bilateral and multilateral APAs. In 1995, the Organization for Economic Cooperation and Development ("OECD") published transfer pricing guidelines that adopted the arm's length standard, consistent with our Section 482 Regulations. Similarly, the OECD Model Tax Convention provides:

> where conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly.

Comparable language outlining the arm's length principle is included – generally in Article 9 – in most income tax treaties to which the United States is a party. Thus, in cases where competent authority negotiations aimed at relieving double taxation under the mutual agreement provisions of our treaties are undertaken, the goal is a mutual agreement consistent with the OECD arm's length standard.

APA OFFICE: STRUCTURE, COMPOSITION, AND OPERATION

(Section 521(b)(2)(A))

Table 1 provides the structure and staffing of the APA Program office as of December 31, 1999:

TABLE 1
APA PROGRAM STRUCTURE AS OF 12/31/99

Director's Office
1 Director (vacant)
1 Secretary to the Director

Branch 1
1 Branch Chief
1 Secretary
7 Team Leaders
2 Economists

Branch 2
1 Branch Chief
1 Secretary
7 Team Leaders
2 Economists

Discussion

Within the IRS, the APA Program is located in the Office of the Associate Chief Counsel (International) ("ACC(I)"), which is part of the Office of Chief Counsel. However, the APA process demands a variety of skills and draws on expertise from other offices within the IRS. The IRS APA team typically includes:

- a "team leader" from the APA Office, who is responsible for leading the IRS team, negotiating with the taxpayer and its representatives, coordinating with the other IRS functions that have a stake in the APA, formulating the U.S. negotiating position in the case of a bilateral APA, and ultimately drafting the APA
- when certain novel or complex issues are presented, an attorney from one of ACC(I)'s technical branches with expertise in such issues
- the revenue agent responsible for the taxpayer's examination with respect to transfer pricing issues, and often that agent's manager and/or the case manager (the manager with overall responsibility for the taxpayer in question)
- an economist from the APA Program or one assigned to assist the examination group
- an attorney from the District Counsel office that provides legal advice to the examination group
- in bilateral cases, an analyst from the Tax Treaty Division, which is part of the Office of the Assistant Commissioner (International).

In addition, in some cases, depending on the circumstances, Field Specialists and personnel from IRS Appeals function participate as members of the APA Team.

MODEL ADVANCE PRICING AGREEMENT
(Section 521(b)(2)(B))

A copy of the model advance pricing agreement currently in use is attached as Appendix A.

APA PROGRAM STATISTICS
(Sections 521(b)(2)(C) and (E))

The statistical information required under Sections 521(b)(2)(C) and (E) is contained in Tables 2 through 6 below:

TABLE 2
APA PROGRAM STATISTICS – APPLICATIONS AND EXECUTED APAs

	91	*92*	*93*	*94*	*95*	*96*	*97*	*98*	*99*	*Total*
Applications Filed[1]	15	21	34	41	58	46	50	67	69	401
APAs executed:										
New APAs executed during calendar year:										
Unilateral		3	7	4	16	11	18[3]	15	17	91
Bilateral	1	6	1	3[2]	5	12	22[4]	22	28	100
Multilateral					1	1			1	3
U.S. Possession						1				1
Renewal APAs executed during calendar year:										
Unilateral					1	3	3	4	8	19
Bilateral					1	1	2	5	4	13
Multilateral									1	1

[1] Applications filed during years 1991 through 1995 are reflected on a September 30 fiscal year-end basis. The number of APA applications filed from 10-1-95 to 12-31-95 were 23, and are included in the total of 58. Applications filed for years 1996 through 1999 are reflected on a calendar year-end basis.
[2] One bilateral APA executed during the 1994 year was inadvertently omitted in prior reports issued by the APA Program.
[3] One unilateral APA was amended during this year but was not counted as an executed APA. Whether an amendment or supplement to an APA is counted as a separate APA depends on the extent and nature of the change.
[4] One bilateral APA revision to a renewal and one supplemental were closed this year but were not counted as executed APAs. See note 3 above.

Revised APAs executed during calendar year: Unilateral Bilateral Multilateral					2				1	2 1
Cumulative total: Unilateral Bilateral Multilateral U.S. Possession	1	3 7	10 8	14 11	33 17 1	47 30 2 1	68 54 2 1	87 81 2 1	112 113 5 1	
Cumulative Total of Executed APAs	1	10	18	25	51	80	125	171	231	231

TABLE 3
APA PROGRAM STATISTICS – CANCELLATIONS AND WITHDRAWALS

	91	*92*	*93*	*94*	*95*	*96*	*97*	*98*	*99*	*Total*
Number of APAs Revoked or Canceled [5]	0	0	0	0	0	0	0	1	0	1
Number of APA Withdrawals	0	9	4	0	4	3	6	7	13	46

TABLE 4
APA PROGRAM STATISTICS-TIME TO COMPLETE APA

MEDIAN NUMBER OF MONTHS

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Median number of months to complete the following categories of APAs:									
Unilateral-New	-	14.0	11.0	15.5	13.0	17.0	22.5	14.0	20.0
Unilateral-Renewal	-	-	-	-	19.0	9.0	6.0	17.0	10.5
Unilateral-Combined	-	14.0	11.0	15.5	15.0	12.5	18.0	15.0	14.0
Bi/Multilateral-New	22.0	17.5	31.0	30.0	22.0	23.5	20.0	31.0	33.0
Bi/Multilateral-Renewal	-	-	-	-	30.0	28.0	47.5	16.0	31.0
Bi/Multilateral-Combined	22.0	17.5	31.0	30.0	22.0	24.0	20.0	30.0	33.0

AVERAGE NUMBER OF MONTHS

	1991	*1992*	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*
Average number of months to complete the following categories of APAs:									
Unilateral-New	-	11.7	13.0	14.0	15.8	16.8	21.0	16.1	22.8
Unilateral-Renewal	-	-	-	-	19.0	8.3	6.3	17.0	10.6
Unilateral-Combined	-	11.7	13.0	14.0	15.9	15.0	18.9	16.2	18.9
Bi/Multilateral-New	22.0	19.7	31.0	26.0	19.6	24.6	22.9	34.5	35.4
Bi/Multilateral-Renewal	-	-	-	-	30.0	28.0	47.5	19.0	32.7
Bi/Multilateral-Combined	22.0	19.7	31.0	26.0	20.9	24.9	24.9	31.6	34.9

[5] One APA was canceled during 1998 due to taxpayer changing its way of doing business.

TABLE 5
APA PROGRAM STATISTICS – PENDING REQUESTS

Total Pending requests for APAs:	187
Pending Unilateral Pending Bilateral	51 136
Pending requests for new APAs: Unilateral Bilateral Pending requests for renewal APAs: Unilateral Bilateral	 35 106 16 30

TABLE 6
APA PROGRAM STATISTICS – INDUSTRIES COVERED

Industry	Number of APAs That Involve This Industry[6]
Financial institutions and products	36
Computer hardware, components, and related products, and computer software	32
Chemicals and related products (industrial, pharmaceutical, cosmetics)	27
Transportation equipment	26
Electrical equipment and components (excluding computers and consumer electronics)	25
Food, beverages, and related products	16
Consumer electronics (excluding computers)	16
Engineering, research, consulting, accounting, management, legal, real estate, subscription, and related services	13
Metal and metal products (excluding machinery)	12
Petroleum refining and related industries	8
Textile mill and apparel products	7
Industrial and commercial machinery	6
Jewelry, sporting equipment, and toys	6
Transportation services	5
Lumber, wood, paper, and related products	5
Telecommunications equipment, components, and services	5
General merchandise and food stores	5
Construction services; construction, ground moving, and mining equipment	4
Printing, publishing, and related industries	4
Marketing, customer support, and employee recruiting services	3
Other	10

[6] This and other tables following will not necessarily total to 231, the number of APAs issued; for example, in this table the number of APAs covering the listed industries totals more than 231 because many APAs cover more than one industry.

RELATIONSHIPS BETWEEN RELATED ORGANIZATIONS, TRADES, OR BUSINESSES
(Section 521(b)(2)(D)(i))

The natures of the relationships between the related organizations, trades, or businesses covered by existing APAs are set forth in Table 7 below:

TABLE 7
NATURE OF RELATIONSHIPS BETWEEN RELATED ENTITIES

Relationship	Number of APAs That Involve This Relationship
U.S. parent, foreign subsidiary(ies)	91
Foreign parent, U.S. subsidiary(ies)	90
Sister companies	22
U.S. company and foreign branches	8
Foreign company and U.S. branch	27
Partnership	2
U.S. Parent, U.S. Possessions subsidiary	1

COVERED TRANSACTI0NS
(Section 521(b)(2)(D)(ii))

The controlled transactions covered by existing APAs are set forth in Table 8 below:

TABLE 8
TYPES OF COVERED TRANSACTIONS

Transaction Type	Number of APAs That Involve This Type
Sale of tangible property into the United States	91
Sale of tangible property from the United States	47
Use of intangible property by a U.S. entity	25
Use of intangible property by a foreign entity	39
Performance of services by a U.S. entity	45
Performance of services by a foreign entity	66
R&D cost sharing - U.S. parent	6
R&D cost sharing - foreign parent	8
Financial products - U.S. parent	2
Financial products - foreign parent	5
Financial products - U.S. branch of foreign company	24
Financial products - foreign branch of U.S. company	9
Commodity trading on globally integrated basis	2

BUSINESS FUNCTIONS PERFORMED AND RISKS ASSUMED, INCLUDING CURRENCY RISK

(Sections 521(b)(2)(D)(ii) and (xii))

The vast majority of APAs have covered transactions that involve numerous business functions and risks. For instance, with respect to functions, companies that manufacture products have typically conducted research and development, engaged in product design and engineering, manufactured the product, marketed and distributed the product, and performed support functions such as legal, finance, and human resources services. Regarding risks, companies have been subject to market risks, R&D risks, financial risks, credit and collection risks, product liability risks, and general business risks. In the APA evaluation process a significant amount of time and effort is devoted to understanding how the functions and risks are allocated amongst the controlled group of companies that are party to the covered transactions.

In their APA proposals taxpayers are required to provide a functional analysis. The functional analysis identifies the economic activities performed, the assets employed, the economic costs incurred, and the risks assumed by each of the controlled parties. The importance of the functional analysis derives from the fact that economic theory posits that there is a positive relationship between risk and expected return and that different functions provide different value and have different opportunity costs associated with them. It is important that the functional analysis go beyond simply categorizing the tested party as, say, a distributor. It should provide more specific information since, in the example of distributors, not all distributors undertake similar functions and risks.

Thus, the functional analysis has been critical in determining the TPM (including the selection of comparables). Although functional comparability has been an essential factor in evaluating the reliability of the TPM (including the selection of comparables), the APA evaluation process has also involved consideration of economic conditions such as the economic condition of the particular industry.

In evaluating the functional analysis, the APA program has considered contractual terms between the controlled parties and the consistency of the conduct of the parties with respect to the allocation of risk. Per the Section 482 regulations, the APA program also has given consideration to the ability of controlled parties to fund losses that might be expected to occur as the result of the assumption of a risk. Another relevant factor considered in evaluating the functional analysis is the extent to which each controlled party exercises managerial or operational control over the business activities that directly influence the amount of income or loss realized. The Section 482 Regulations posit that parties at arm's length will ordinarily bear a greater share of those risks over which they have relatively more control.

In some cases it has been necessary to employ special adjustments that quantify differences in functions, risks, and markets between the tested party or transactions and comparables. The question of whether and how to adjust for currency risk exposure has been an area of particular interest in APAs. Although there are several types of currency risk (e.g., transactional, translation, and economic), economic currency risk has been the area of greatest discussion. Economic currency risk represents the risk that companies incur when their input costs are denominated in a currency that is different than that of their competitors. For example, if a foreign multinational manufactures product in its home country for distribution into the United States then the company's competitive position is eroded (strengthened) if the home country's currency appreciates (depreciates) relative to the U.S. dollar, assuming that the firm's competitors face U.S. dollar based costs.

There are a variety of ways in which this issue has been treated in APAs. In the vast majority of cases no adjustment has been incorporated into the APA agreement. This may be because the comparables experience similar currency exposure, the tested party is assumed not to bear any of the currency risk, the currency fluctuations have not been material, or the taxpayer is able to pass through substantially all of its currency risk to end users. In certain APAs a critical assumption has been inserted that requires the parties to renegotiate the agreement in the event that exchange rate fluctuations exceed certain parameters.

Two types of currency adjustments have been employed in APAs. Both have been employed in conjunction with the comparable profits method ("CPM"). The first type of adjustment specifies that, for a given percentage change in the exchange rate, the tested party's gross margin will be adjusted by a percentage that is less than the percentage change in the exchange rate. The second type of adjustment has provided a band of exchange rate movements for which no adjustment would be made. For exchange rate movements outside of the no adjustment band, the operating margin of the tested party is adjusted based upon the extent of the exchange rate fluctuation. Both of these approaches have generally called for positive or negative adjustments depending on whether a currency appreciates or depreciates against the dollar.

RELATED ORGANIZATIONS, TRADES, OR BUSINESSES WHOSE PRICES OR RESULTS ARE TESTED TODETERMINE COMPLIANCE WITH APA TPMs

(Section 521(b)(2)(D)(iii))

The related organizations, trades, or businesses whose prices or results are tested to determine compliance with TPMs prescribed in existing APAs are set forth in Table 9 below:

TABLE 9
RELATED ORGANIZATIONS, TRADES OR BUSINESSES WHOSE PRICES OR RESULTS ARE TESTED

Type of Organization	Number of APAs That Involve This Type
U.S. distributor	83
Foreign distributor	35
U.S. manufacturer	46
Foreign manufacturer	45
U.S. provider of services	46
Foreign provider of services	50
U.S. participant in cost sharing arrangement	14
Foreign participant in cost sharing arrangement	14
U.S. licensor of intangible property	14
Foreign licensor of intangible property	12
U.S. licensee of intangible property	23
Foreign licensee of intangible property	33
U.S. dealer in financial products	30
Foreign dealer in financial products	22
U.S. dealer in commodities	2
Foreign dealer in commodities	2
Publisher and web site operator	1

With some TPMs, only the results of one party are tested. With the resale price method under Reg. § 1.482–3(c), only the distributor's gross margin is tested. With the cost plus method under Reg. § 1.482–3(d), only the manufacturer's markup on costs is tested. With the comparable profits method under Reg. § 1.482–5, one party's profitability (normally that of the simpler party, with no or fewer pertinent intangible assets) is tested. For provision of services under Reg. § 1.482–2(b), typically only the provider of services is tested. With some TPMs, the prices or results of both parties are tested. For example, with the comparable uncontrolled price method under Reg. § 1.482–3(b), the price charged between the related parties is tested. Similarly, with the comparable uncontrolled transaction method under Reg. § 1.482–4(c), the compensation for intangibles paid between the related parties is tested. With profit split methods under Reg. § 1.482–6, and for financial products cases under Prop. Reg. § 1.482–8, the split of profits between the related parties is tested in light of each party's contributions. With cost sharing under Reg. § 482–7, the parties' sharing of costs is tested in light of the parties' reasonably anticipated benefits.

TPMs AND THE CIRCUMSTANCES LEADING TO THE USE OF THOSE TPMs
(Section 521(b)(2)(D)(iv))

The TPMs used in existing APAs are set forth in Tables 10-14 below:

TABLE 10
TPMs USED FOR TRANSFERS OF TANGIBLE AND INTANGIBLE PROPERTY

TPM	Number of APAs That Involve This TPM
Comparable Uncontrolled Price (CUP) (tangible property only)	7
CUP based on reference to published market data	2
Comparable Uncontrolled Transaction (CUT) (intangible property only)	12
Resale Price (tangible property only)	10
Cost Plus (tangible property only)	10

Comparable Profits Method (CPM): PLI is operating margin	57
Comparable Profits Method (CPM): PLI is gross margin	12
Comparable Profits Method (CPM): PLI is return on assets or capital employed	17
Comparable Profits Method (CPM): PLI is Berry ratio (markup on SG&A)	13
Comparable Profits Method (CPM): PLI is a markup on costs (normally total costs)	15
Commission computed as percentage of sales minus expenses reimbursed by related supplier	1
Operating income point that depends on sales change and on internal management measure of profitability	2
Comparable Profit Split	1
Residual Profit Split	14
For globally integrated commodity trading, profit split by formula based on compensation and commodity positions	2
Other Profit Split	8
Profit set to sum of a certain return on assets and a certain operating margin; this method combined with an other profit split	1
Agreed royalty (fixed rate)	7
Agreed royalty (rate varies with operating margin)	2
Agreed royalty (rate varies with ratio of R&D to sales)	1
Taxpayer's worldwide royalty schedule justified by CPM analysis	1
R&D cost sharing amount plus a percentage of sales	1

TABLE 11
TPMs USED FOR SERVICES

TPM	Number of APAs That Involve This TPM
Charge-out of cost with no markup	17
Charge-out of cost with markup	41
Commission as percentage of sales	2
Markup on costs, but R&D expenses limited to certain percentage of sales	1
Asset-proportionate share of system-wide return on assets, but limited to certain range of markup on costs	1
Profit is the sum of a markup on costs, a percentage of sales of patented products resulting from contract R&D performed by tested party, and other factors	1
For real estate management, fee is percentage of rents plus percentage of total value of new leases, but not less than a certain markup on costs	1
Dollar cap on management fee	1
Profit split using five-factor formula	1
Profit split, subject to a floor on operating margin	1

TABLE 12
TPMs USED FOR FINANCIAL PRODUCTS

TPM	Number of APAs That Involve This TPM
Profit split under Notice 94–40/Prop. Reg. 1.482–8	20
Residual profit split	2
Interbranch allocation (*e.g.*, foreign exchange separate enterprise)	18
Market-based commission	2
Taxpayer's internal allocation system	1

TABLE 13
TPMs USED FOR CONTRIBUTIONS TO COST SHARING ARRANGEMENTS

Cost Allocated By	Number of APAs Using This Allocation
Sales	7
Sales and production costs	2
Sales and profit	2
Profit	2
Raw material costs	1

TABLE 14
TPMs USED FOR COST SHARING BUY-IN PAYMENTS

TPM	Number of APAs That Involve This TPM
Capitalized R&D	2
The sum of two payments, one based on capitalized R&D and the other based on a residual profit split analysis	2
Market capitalization	1
Residual profit split with comparable acquisitions check	1

DISCUSSION

In general, the TPMs set out in Tables 10-14 above track the methods specified in the Regulations. Reg. § 1.482–3(a) provides the following methods to determine income with respect to a transfer of tangible property: the comparable uncontrolled price ("CUP") method (Reg. § 1.482–3(b)); the resale price method (Reg. § 1.482–3(c)); the cost plus method (Reg. § 1.482–3(d)); the comparable profits method ("CPM") (Reg. § 1.482–5); and the profit split method (Reg. § 1.482–6). Reg. § 1.482–4 provides the following methods to determine income with respect to a transfer of intangible property: the comparable uncontrolled transaction ("CUT") method (Reg. § 1.482–4(c)); CPM; and profit split. In addition, with respect to both tangibles and intangibles, methods not specified in these sections may be used if they provide a more reliable result; such methods are referred to as "unspecified methods." In addition to these methods, the Regulations provide for pricing methods applicable to transactions other than the transfer of tangible or intangible property. Reg. § 1.482–2(a) provides rules concerning the proper treatment of loans or advances between controlled taxpayers. Reg. § 1.482–2(b) deals with provision of services, providing that services ordinarily should bear an arm's length charge, and that in certain circumstances an arm's length charge may be deemed to be the cost of providing the services. Finally, Reg. § 1.482–7 provides rules for qualified cost-sharing arrangements under which the parties agree to share the costs of development of intangibles in proportion to their shares of reasonably anticipated benefits from their use of the intangibles assigned to them under the agreement. APAs dealing with such cost sharing agreements deal with both the method of allocating costs among the parties, and the determination of the amount of the "buy-in" payment due in the case of preexisting intangibles transferred as a result of entering into the cost sharing agreement.

Under the Regulations, there is no strict hierarchy of methods, nor is one method exclusively applicable to a given type of transaction, while a different method would be exclusively applicable to a different type of transaction. Instead, the Regulations prescribe a more flexible "best method" approach. The best method is the method that provides the most reliable measure of an arm's length result. Reg. § 1.482–1(c)(1). Usually, data based on results of transactions between unrelated parties provide the most objective basis for determining an arm's length price. Reg. § 1.482–1(c)(2). In such cases, reliability is a function of the degree of comparability between the controlled transactions or taxpayers and the uncontrolled comparable transactions or parties, and the quality of the data and assumptions used in the analysis. Reg. § 1.482–1(c)(2). Factors affecting comparability include the industry involved, the functions performed, the risks assumed, contractual terms, the relevant market and market level, and other considerations. Reg. § 1.482–1(d)(3). See also the discussion of comparables below.

These principles are central to the evaluation of an APA case by the APA Team. Typically, the Team will determine the relevant facts of the case; once the facts are determined, the Team will focus on determining the appropriate TPM by identifying comparable uncontrolled data, determining the degree of comparability of such data, making such adjustments (either to the taxpayer's or tested party's data or to the comparables) as are necessary to make the data more comparable (and thus more reliable), and determining which TPM would be most reliable, and thus the best method, in light of the available data.

This in essence is the function performed by the APA Team. The Team must evaluate each case through an application of the principles of the Regulations. APA cases often tend to be more difficult than a typical transfer pricing case; if the case were easy to resolve, there would be less need to resort to the APA process. Given this fact, and the nature of transfer pricing law and analysis, the APA Team must focus on the particular facts of the case and must have a clear, detailed understanding of the taxpayer's business. The Team then evaluates the taxpayer's functions and risks, the industry involved, market conditions, contractual terms, availability of data, and all the other factors that are relevant under the Regulations. Analysis of the interplay of the facts and transfer pricing principles present in the case, coupled with careful consideration of the taxpayer's views, allows the Team to reach a reasoned, case-specific application of the arm's length principle under Section 482.

Such analysis of real-life cases has proven a valuable way for the Service to learn more about taxpayers' businesses, and their concerns and difficulties in attempting voluntarily to comply with their tax obligations. This can enable the Service to provide better and more timely guidance. At the same time, in the interim, taxpayers can achieve certainty concerning their prospective filing obligations through participation in the APA process. A good example of such synergy between the APA Program and issuance of general guidance is provided by the proposed "global dealing" regulations (63 Fed. Reg. 11177 [REG–208299–90] (March 6, 1998)). The Service's early experience with "global dealing" APAs was described in Notice 94–40, 1994–1 C.B. 351. This Notice described the methodologies that had been used for a particular type of global dealing cases. In these cases, a global financial institution or affiliated group of companies would continuously trade securities and other financial products on a twenty-four hour basis, with responsibility for the "book" of positions passing from location to location in accordance with the passing of normal business hours in a given location. Existing rules created uncertainty regarding the appropriate treatment of such fact patterns. APAs bridged the gap until more general guidance could be issued.

Review of Table 10 reveals that the great majority of APA TPMs applicable to the transfer of tangible or intangible property are specified methods under the Regulations. The CUP method has been used when it has been possible under the facts of the cases submitted to identify uncontrolled transactions with the required degree of comparability between products, contractual terms, and economic conditions. See Reg. § 1.482–3(b)(2)(ii). In many cases data concerning external CUPs was difficult to obtain; unrelated taxpayers dealing in the comparable product would ordinarily also deal in other items as well, and it is sometimes difficult to separate the pricing of the relevant transactions from the other results, based on publicly reported available data. Thus, in the APA Program's experience, there has been a tendency to utilize internal CUPs. In addition, in two cases, where the covered product involved a commodity, publicly available market data provided a comparable price that could be referred to for purposes of establishing a CUP.

For similar reasons, APAs applying the CUT method have tended to rely on internal transactions between the taxpayer and unrelated parties; *i.e.*, it has often been difficult to identify an external CUT. For example, in a case dealing with a royalty for a nonroutine intangible such as a trademark, it can be difficult to identify an unrelated party royalty arrangement that is sufficiently comparable, due to the unique nature of the nonroutine intangibles. To avoid these difficulties, some cases have utilized a "step royalty" arrangement to determine the proper transfer price for use of a unique intangible. For example, taxpayers have argued that an intangible was very valuable and therefore a high royalty rate was appropriate. Because there were no exact or closely similar comparables, it was difficult to demonstrate objectively whether the taxpayer was correct. A sliding scale, or step royalty, in conjunction with a CPM analysis, has been used to resolve such cases. The premise of such APAs was that, if the intangible truly had great value, the taxpayer would earn higher than normal return from its activities utilizing the intangible. Conversely, as the value of the intangible decreased, the taxpayer's pre-royalty results would be in the routine arm's-length range. Therefore, the royalty rate adopted in these APAs increases as the licensee's profitability increases.

Based on the facts and circumstances of the cases evaluated by the APA Program, ten APAs to date have utilized a strict transactional resale price method. Similar considerations concerning comparability and data availability apply to this method.

A transactional cost plus method has been applied in ten cases as well. This method has proved easier to apply than the other transactional methods because the taxpayer's costs are identifiable and it is likely to be easier to identify functionally comparable transactions for purposes of determining an appropriate arm's length markup than it is to identify closely similar products in the case of a CUP. See Reg. § 1.482–3(d)(3)(ii). In other words, for example, a manufacturer might perform similar functions and assume similar risks even though the product manufactured is not identical or nearly identical to the taxpayer's product.

The CPM is frequently applied in APAs. This is because reliable public data on comparable business activities of independent companies can be more readily available than potential CUP data, and comparability of resources employed, functions, risks, and other relevant considerations is more likely to exist than comparability of product. The CPM also tends to be less sensitive than other methods to differences in accounting practices between the tested party and comparable companies, *e.g.* classification of expenses as cost of goods sold or operating expenses. Reg. §§ 1.482–3(c)(3)(iii)(B), 1.482–3(d)(3)(iii)(B). In addition, the degree of functional comparability required to obtain a reliable result under the CPM is generally less than required under the resale price or cost plus methods, because differences in functions performed often are reflected in operating expenses, and thus taxpayers performing different functions may have very different gross profit margins but earn similar levels of operating profit. Reg. § 1.482–5(c)(2).

As can be seen from Table 10, a variety of profit level indicators ("PLIs") has been used in connection with application of the CPM. The rationale for choosing

which PLI to use in a given case turns on all the factors contained in the Regulations, including availability and reliability of information, and the nature of the activities of the tested party. For example, return on assets or return on capital employed ("ROCE") may be most reliable in cases where the level of operating assets has a high correlation to profitability, that is, where the operating assets play a greater role in generating profits – for example, a manufacturer's operating assets such as property, plant, and equipment could have more impact on profitability than a distributor's operating assets, since often the primary value added by a distributor is based on services it provides, which are often less dependent on level of operating assets. Reg. § 1.482–5(b)(4)(i). The reliability of ROCE has also been dependent on the structure of the taxpayer's assets and their similarity to those of the comparables, since different asset categories can have different rates of return.

Other PLIs applied by APAs in conjunction with the CPM are various financial ratios. These include operating margin ("OM"), Berry ratio, markup on costs, and gross margin. OM is defined as the ratio of operating profit to sales. The Berry ratio[7] is defined as the ratio of gross profit to operating expenses. A Berry ratio has in some cases been used when services provided (for example, a low-risk distributor providing marketing and distribution services) are the main source of value added by the tested party, and the expenses incurred for providing those services are classified as operating expenses rather than costs of goods sold. In such cases a Berry ratio is essentially a markup on operating expenses. OM has been used when functions of the tested party are not as closely matched with the available comparables. Markup on costs (normally total costs) has been used when the taxpayer's sales are a controlled transaction, because it relies on an uncontrolled cost figure rather than on the controlled sales figure. This method has also been used where it is common industry practice to set prices by reference to costs, for example, for contract manufacturers. Occasionally, certain costs have not been marked up, such as product-specific taxes reimbursed by the purchaser. In general, gross margin has not been favored as a PLI because the categorization of expenses as operating expenses or cost of goods sold may be subject to manipulation, resulting in understatement of taxable income even where gross margins are within an arm's length range.

The relative utility of each PLI is the subject of much discussion and analysis in each case and depends heavily on the facts and circumstances of the particular case. The APA Team's analysis will often consider several different PLIs; if the results tend to converge, that may provide additional assurance that the result is reliable. If there is a broad divergence between the different PLIs, the Team may derive insight into important functional or structural differences between the tested party and the comparables. For example, such divergence may lead to a discovery that the taxpayer's indicated asset values are not reliable or comparable, such as in the case of a largely depreciated but still valuable asset base.

Profit split methods are used most often when both sides of the controlled transactions own valuable nonroutine intangibles. If all such intangibles were owned by only one side, the other side would usually be the simpler party and therefore, its functional contribution would be more easily valued. Where both sides possess nonroutine intangibles for which there are no good comparables, however, a profit split method can be the most reliable method of establishing an arm's length price. APAs have used both comparable profit splits and residual profit splits, as described in the Regulations. In addition, APAs have used as an unspecified method other types of profit splits; for example, an allocation of profits based on a weighted allocation formula with operating assets and certain operating expenses as factors, allocations based on the relative value of contributions of the parties, or allocations based on compensation and activities similar to the Notice 94–40 (1994–1 C.B. 351), profit split utilized in some financial products cases.

Profit splits have also been used in a number of financial products APAs where the primary income-producing functions are performed in more than one jurisdiction. As described in Notice 94–40, *supra*, these APAs have tended to use a multi-factor formula to represent the contribution of various functions to world-wide profits. Residual profit splits, as provided in Prop. Reg. § 1.482–8(e)(6), have been applied in two cases where routine functions, such as back office functions, were readily valued. The residual profits were allocated on the basis of a case-specific multi-factor formula similar to that discussed in Notice 94–40. In two cases, where all the intangibles were held in one jurisdiction and the other jurisdictions provided routine marketing functions, a market-based transactional commission was used as the most reliable measure of an arm's length return for those routine services. In one case the APA Team determined that the taxpayer's internal profit allocation method provided an arm's length result. In this case, reliability was enhanced because this internal method was used in determining arm's length payments such as compensation and bonuses. Prop. Reg. 1.482–8(e)(5)(iii).

A separate group of financial products cases involves U.S. or foreign branches of a single taxpayer corporation that operate autonomously with respect to the covered transactions, for example the purchase and sale to customers of a financial product such as foreign currency. Pursuant to the business profits articles of the relevant income tax treaties, several APAs determined the appropriate amount of profits attributable to each branch from such activity by reference to the branches' internal accounting methods. The branch results took into account all trades, including interbranch and/or interdesk trades. In order for this method to provide a reliable result, however, it was necessary to ensure that all such controlled trades be priced on the same market basis as uncontrolled trades. To test whether this was so, the branch's controlled trades were matched with that branch's comparable uncontrolled trades made at times close to the controlled trades. A statistical test would then be performed to detect pricing bias, by which the controlled trades might as a whole be priced higher or lower than the uncontrolled trades. See the discussion under "Nature of Ranges and Adjustment Mechanisms" below.

In APA cases involving a cost sharing arrangement ("CSA") under Reg. §

[7] Named after Professor Charles Berry, who used the Berry ratio when serving as an expert witness in *E.I. DuPont de Nemours & Co. v. United States*, 608 F.2d 445 (Ct.Cl. 1979).

1.482–7, the APA Teams have worked with the taxpayers to ensure that the arrangement in question meet the requirements of Reg. § 1.482–7(b). In particular, the Team must determine that the method of determining each participant's share of costs is consistent with the reasonably anticipated benefits that participant is likely to realize from exploitation of the intangible that is the subject matter of the CSA. In cases where the CSA involves transfer of existing technology, the Team must also determine the appropriate "buy-in" under Reg. § 1.482–7(g)(2). Table 13 shows the methods of allocating cost sharing payments adopted in existing APAs, and Table 14 shows the methods of determining the buy-in. These methods have been adopted on a case by case basis, depending on the taxpayer's facts and circumstances.

APAs that have dealt with provision of services have applied Reg. § 1.482–2(b)(3) to determine an arm's length charge for such services; in general, services have been charged out at cost when they were not an integral part of the business activity of either the party rendering the services or the recipient of the services. In cases where the services were integral, or where it was otherwise determined that parties dealing at arm's length would not have charged out the cost of services, the tendency has been to use a cost-plus method to determine an arm's length fee. In six cases, other methods of determining an arm's length fee have been determined to be the best method, as seen in Table 11.

CRITICAL ASSUMPTIONS
(Section 521(b)(2)(D)(v))

APAs include critical assumptions upon which their respective TPMs depend. Critical assumptions are objective business and economic criteria that form the basis of a taxpayer's proposed TPM. A critical assumption is any fact (whether or not within the control of the taxpayer) related to the taxpayer, a third party, an industry, or business and economic conditions, the continued existence of which is material to the taxpayer's proposed TPM. Critical assumptions might include, for example, a particular mode of conducting business operations, a particular corporate or business structure or a range of expected business volume. Rev. Proc. 96-53, § 5.07. Failure to meet a critical assumption may render an APA inappropriate or unworkable.

A critical assumption may change (and/or fail to materialize) due to uncontrollable changes in economic circumstances, such as a fundamental and dramatic change in the economic conditions of a particular industry. This type of critical assumption may be defined in terms of a significant variance from budgeted sales volume. In addition, a critical assumption may change (and/or fail to materialize) due to a taxpayer's actions that are initiated for good faith business reasons, such as a change in business strategy, mode of conducting operations, or the cessation or transfer of a business segment or entity covered by the APA.

Effects of Critical Assumptions

If a critical assumption has not been met, the APA may be revised by agreement of the parties. If such agreement cannot be achieved, the APA may be canceled. If a critical assumption has not been met, it requires taxpayer's notice to and discussion with the Service, and possible Competent Authority activity. Rev. Proc. 96–53, § 11.07. Failure of a critical assumption may also provide an automatic adjustment in the TPM results.

Critical assumption provisions are crucial to the APA because a TPM is premised on certain assumptions that apply to a particular taxpayer, its industry, and the dynamics of the economy. Critical assumptions provide flexibility in an APA by recognizing the reality of change in business cycles and economic circumstances and their effects on varying arm's length returns. Whether critical assumptions change (and/or fail to materialize) is subject to the examination process.

General Critical Assumption

Included in the model APA is the following critical assumption:

The business activities, functions performed, risks assumed, assets employed, and financial [and tax] accounting methods and categories [and estimates] of Taxpayer shall remain materially the same as described in Taxpayer's request for this APA.

Taxpayer-Specific Critical Assumptions

The APAs concluded as of December 31, 1999, include approximately 160 different critical assumptions in addition to the model APA critical assumption noted above. Many of these critical assumptions appear in more than one APA. Most of the critical assumptions reflect specific terms and factors of each taxpayer in an elaboration of the general model APA critical assumption. The critical assumptions can be subdivided into the following categories:

(i) operational,
(ii) legal,
(iii) tax,
(iv) financial,
(v) accounting, or
(vi) economic.

These various categories of critical assumptions are discussed below.

Operational Critical Assumptions

Over 100 of the critical assumptions fall into the operational category. It is not surprising that this is the largest category of critical assumptions. APAs by their nature are factually intensive and reflect the specific operations of each taxpayer and its related parties. In agreeing to a TPM in an APA, the APA Team is basing its position on the facts presented and thus implicitly upon the assumption that those operational facts will remain the same. In addition to the general critical assumption to that effect, many APAs include specific critical assumptions relating to important factual underpinnings of the decision to adopt the TPM.

Over twenty of these operational critical assumptions involve costs or expenses, such as how the taxpayer defines, computes, allocates and apportions costs and expenses. Also included are critical assumptions concerning limits on the amount and manner by which expenses and costs can vary. An example of this type of critical assumption is that a U.S. subsidiary's deductions for restructuring fees shall not exceed a stated maximum dollar amount.

Six operational critical assumptions involve sales. These concern limits on sales mixes, maximum sales amounts, projections of sales and permissible sales trends and variations. An example of this type of critical assumption is that the combined sales of covered products for each APA year must be within 20% of the previous year.

Three operational critical assumption involve new products. They either include or exclude new products from coverage of the APA. They also control how a new product will be treated. An example of this type of critical assumption is that certain new products will not be covered.

Five operational critical assumptions involve permissible variations in items other than sales or expenses. These include how new or disposed of affiliates are treated, to what extent inventories can fluctuate, or to what extent covered purchases can be imported finished products. An example of this type of critical assumption is that the share of covered products that are imported finished goods can vary by X% from the historical baseline share percentage of imported finished goods.

The largest number (over 60) of operational critical assumptions involve limits on change. These critical assumptions state in a specific way that the following items remain substantially the same: customers, products, risks, functions, business methods, assets, pricing policies, absence of catastrophic events, business structure, presence and effect of a cost sharing agreement, functional currency, operating assets, presence or absence of intangible assets, intangible asset ownership, parties to the agreement, licensee agreements, specific personnel, location of specific personnel, presence or absence of commissions, and royalty amounts and percentages. An example of this type of critical assumption is that the location of a particular key executive may not change.

Other operational critical assumptions involve annual review of functions, dates of transfer of property, and maintenance of records. An example of this type of critical assumption is that the gross profit from certain transactions will be recorded in a regularly compiled database.

Legal Critical Assumptions

Fourteen critical assumptions involve legal issues. They include whether a competent authority agreement is conditioned, canceled or has an effect on rollback years (prior years not covered by the APA). An example is that the competent authorities' mutual agreement, which is conditioned on the system profit remaining above a specified minimum level, will remain in effect (*i.e.*, that such condition will continue to be satisfied).

Other critical assumptions of this nature involve liquidations, dissolutions, customs law changes, major regulatory changes, new import or export barriers, and maintenance of a distributor agreement in a specific form. An example of this type of critical assumption is that customs duties on imported covered products shall not increase or decrease by some stated parameter.

Others involve which controlled entity has title to inventory and production equipment, or which controlled entity is required to maintain guarantees, warranties, or product liability. An example of this type of critical assumption is that a parent corporation must maintain existing guarantees for all liabilities of its subsidiary, including its debt and product liability guarantees.

Tax Critical Assumptions

Eleven critical assumptions involve tax issues. These issues include estimated tax liability, period of limitation on assessment, tax effect of specified expenses, sourcing of income, Subpart F income, permanent establishment, foreign tax credit limitation, increasing coverage to other controlled foreign corporations, the ability to change a specified tax election, ability to file for a refund, and a condition of subsequently entering into a closing agreement for roll back years. An example of this type of critical assumption is that the period of limitation on assessments shall be kept open for all APA years until such period expires for the last APA year under U.S. tax law.

Financial Critical Assumptions

Eighteen types of critical assumption are financial in nature. These involve limitations on system loss, intangible profit projections, buy-in payments, lack of currency risk, and valid business reason for debt. Also included in this category are a number of requirements for maintaining various financial ratios such as profit splits, Berry ratios, operating profit margins, and gross profit margins, within prescribed ranges or within limits. An example of this type of critical assumption is that the TPM may not yield a gross margin outside A% to B% for a controlled subsidiary, nor may the combined operating margins be outside C% to D% for the parent and the subsidiary, unless due to valid business reasons or attributable to economic conditions beyond the parent's control.

Accounting Critical Assumptions

Seven critical assumptions involve accounting methods or practices. These include assumptions regarding the use of generally accepted accounting principles, favorable certified opinions, mark to market accounting, consistency of accounting computations for all related parties, methods of accounting for foreign currency gains and losses, and unchanged methods for both financial and tax accounting. An example of this type of critical assumption is that manufacturing costs must be computed in the same manner by U.S. and foreign members of an affiliated group.

Economic Critical Assumptions

Eight critical assumptions involve economic and financial conditions. These include assumptions regarding interest rates and changes in interest rates. They also include assumptions that there will not be significant changes in market conditions, technology, product liability, product design, process design, and market share. An example of this type of critical assumption is that there shall not be an unexpected economic development that materially affects a company's market share or market price of a covered product.

SOURCES OF COMPARABLES, COMPARABLE SELECTION CRITERIA, AND NATURE OF ADJUSTMENTS TO COMPARABLES AND TESTED PARTIES

(Sections 521(b)(2)(D)(v), (vi) and (vii))

At the core of most APAs are comparables. The APA program works closely with taxpayers to find the best and most reliable comparables for each covered transaction. In some cases, CUPs or CUTs can be identified, with the attendant product- or intangible-specific analysis of comparability and reliability. In other cases, comparable business activities of independent companies are utilized in applying the CPM or residual profit split

methods. In the APA Program's experience, CUPs and CUTs have been most often derived from internal transactions of the taxpayer. But other cases have utilized third party CUPs or CUTs from external transactions.

For profit-based methods where comparable business activities or functions of independent companies are sought, the APA Program typically has applied a three-part process. First, a pool of potential comparables has been identified through broad searches. From this pool, companies having transactions that are clearly not comparable to those of the tested party have been eliminated through the use of quantitative and qualitative analyses, *i.e.*, quantitative screens and business descriptions. Then, based on a review of available descriptive and financial data, a set of comparable companies or transactions has been finalized. The comparability of the finalized set has then been enhanced through the application of adjustments. These steps of identifying potential comparables, selecting comparables from the pool, and adjusting the comparables, are discussed in turn below.

Searching for Comparables

Comparables used in APAs can be U.S. or foreign companies. This depends, of course, on the relevant market, the type of transaction being evaluated and the results of the functional and risk analyses. In general, comparables have been located by searching a variety of databases which provide data on U.S. publicly-traded companies and on a combination of public and private non-U.S. companies. Table 15 summarizes some of the common databases that have been used for existing APAs.

TABLE 15
COMPARABLES DATABASES USED IN APA ANALYSES

VENDOR	DATABASE*	COVERAGE
Bureau van Dijk	Amadeus Jade Fame	European companies Japanese companies U.K. companies
Disclosure	SEC CanCorp Worldscope	U.S. public companies (primarily) Canadian companies Global companies
Moody's	Domestic International	U.S. public companies Non-U.S. companies
Standard & Poor's	Compustat (Research Insight North America) Global Vantage (Research Insight Global)	U.S. & Canadian public companies (primarily) Non-U.S. companies

* Many vendors now package their data with more than one type of access software. This table shows the major databases without regard to the "front-end" software used to access them. In addition, it does not show other vendors who package existing databases together in products.

Although comparables were most often identified from the databases cited above, in some cases comparables were found from other sources. Chief among this group are comparables derived internally from taxpayer transactions with third parties. In just over 10 percent of all APAs, there were transactions that were evaluated with reference to internal comparable uncontrolled transactions. Also used in a few cases was information available from trade publications in specific industries, and comparables derived from taxpayer information on competitors.

Selecting Comparables

Initial pools of potential comparables have been generally derived from the databases shown in Table 15 using a combination of industry and keyword identifiers. Then, the pool has been refined using a variety of selection criteria specific to the transaction or entity being tested and the transfer pricing method being used.

The databases listed above in Table 15 allow for searches by industrial classification (generally, U.S. Standard Industrial Classification ("SIC")), by keywords, or by both. These searches can yield a number of companies whose business activities may or may not be even remotely comparable to those of the entity being tested. Therefore, so called "comparables" based solely on SIC or keyword searches are almost never used in APAs.

Rather, pools of initially identified companies are examined closely. This examination consists of a combination of quantitative screens and qualitative evaluations. The application of multiple quantitative screens to select comparables, without also analyzing descriptive information about the companies, has not generally been acceptable APA practice. Rather, companies have been accepted or rejected as comparables based on a combination of screens, business descriptions, and other information found in a company's Annual Report to shareholders and filings with the U.S. Securities and Exchange Commission ("SEC").[8]

In virtually all cases, business activities are required to meet certain basic comparability criteria to be considered comparables. Functions, risks, economic condi-

[8] While the framework is the same for searches for U.S. and non-U.S. comparables, there is generally less descriptive information publicly available for non-U.S. companies. Therefore, selection criteria can be more general for non-U.S. searches.

tions, and the property (product or intangible) and services associated with the transaction must be comparable. Determining comparability can be difficult – the goal has been to use comparability criteria restrictive enough to eliminate companies that are not comparable, but yet not so restrictive as to have no comparables remaining. The APA Program normally has begun with relatively strict comparability criteria and then has relaxed them slightly if necessary to derive a pool of comparables.

The APA Program has applied a combination of criteria to determine comparability of economic conditions. Specifically, it frequently has combined "same industry" criterion with criteria focusing on the level of market served, the maturity of the company (minimum or maximum number of years of operation) and/or the geographic market served (minimum or maximum percentage of sales in a geographic area and/or percentage of government sales.)

In addition, the APA Program has generally required the potential comparables to have complete financial data available for a specified period of time. Sometimes this has been three years, but it can be more or less, depending on the circumstances of the controlled transaction. Using a shorter period might result in the inclusion of companies in different stages of economic development or use of atypical years of a company subject to cyclical fluctuations in business conditions.

Beyond these criteria and screens which are most often applied, many covered transactions have been tested with comparables that have been chosen using additional criteria and/or screens. These include sales level criteria and tests for financial distress and product comparability.

These common selection criteria and screens have been used to increase the overall comparability of a group of companies and as a basis for further research. The sales level screen, for example, has been used to remove companies that, due to their size, might face fundamentally different economic conditions from those of the entity or transaction being tested.

In addition, many APA analyses have incorporated some form of selection criteria related to removing companies experiencing "financial distress" due to concerns that companies in financial distress often have experienced unusual circumstances that would render them not comparable to the entity being tested. These criteria include: operating losses in a given number of years, an unfavorable auditor's opinion, or bankruptcy.

As the transfer pricing regulations state in Reg. § 1.482–1(d)(3)((v), the importance of product comparability depends on the transfer pricing method being used. In using methods that rely on the identification of comparable independent companies, the APA Program has generally required less product comparability than when using methods that rely on comparable uncontrolled prices and licensing transactions. Nonetheless, product comparability, as determined from publicly available corporate information, has been used as a selection criterion when possible.

An additional important class of selection criteria is that which relates to the development and ownership of intangible property. In many cases in which the entity being tested is a manufacturer, several criteria have been used to ensure, for example, that if the controlled entity does not own significant manufacturing intangibles or conduct research and development ("R&D"), neither will the comparables. These selection criteria have included determining the importance of patents in a company or screening for R&D expenditures as a percentage of sales or costs. Another criterion used in some cases has been a comparison of the book and market values of a company; this can be another indicator of intangible value. Again, quantitative screens related to identifying comparables with significant intangible property generally have been used in conjunction with an understanding of the comparable derived from publicly available business information.

Selection criteria relating to asset comparability and operating expense comparability have also been used at times. A screen of property, plant, and equipment ("PP&E") as a percentage of sales or assets, combined with a reading of a company's SEC filings, has been used to help ensure that distributors (generally lower PP&E) were not compared with manufacturers (generally higher PP&E), regardless of their SIC classification. Similarly, a test involving the ratio of operating expenses to sales or total costs has helped to determine whether a company undertakes a significant marketing and distribution function. This has been used in circumstances when complete descriptive information about a company's functions was not available.

Adjusting Comparables

After the comparables have been selected, the regulations require that "[i]f there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results." Reg. § 1.482–1(d)(2). In almost all cases involving income-statement-based profit level indicators ("PLIs"), certain "asset intensity" or "balance sheet" adjustments for factors that have generally agreed-upon effects on profits have been carried out. In addition, in specific cases, additional adjustments have been performed to improve reliability.

The most common asset intensity adjustments used in APAs include adjustments for differences in accounts receivable, inventories, and accounts payable. In practice, when data has been available, most APAs have included these adjustments, regardless of whether or not their effect is material. Further, while there is no single standard adjustment mechanism, the different methodologies used have tended to achieve similar results.

The APA Program has required that data must be compared on a first-in first-out ("FIFO") accounting basis. Although financial statements may be prepared on a last-in first-out ("LIFO") basis, cross-company comparisons are less meaningful when one or more companies use LIFO inventory accounting methods. This adjustment directly affects costs of goods sold and inventories, and therefore affects both profitability measures and inventory adjustments.

The APA Program has required adjustments for receivables, inventory, and payables based on the principle that holding assets such as receivables and inventory is a cost to the entity holding them and a benefit to customers and/or suppliers (those on either side of a transaction with the entity holding the assets). Such adjustments are based on the assumption that the cost of holding these assets is

equal to their carrying cost. Conversely, the holding of accounts payable is considered to be a benefit to the entity holding them, in that they are a source of funds. This benefit has generally been assumed to be equal to the cost of funds.

To compare the profits of two entities with different relative levels of receivables, inventory, or payables, the APA Program has estimated the carrying costs of each item and adjusted profits accordingly. Although somewhat different formulas have been used in specific APA cases, Appendix B presents one set of formulas used in many APAs.[9] Underlying these formulas are the notions that (1) balance sheet items should be expressed as mid-year averages, (2) formulas should try to avoid using data items that are being tested by the transfer pricing method (for example, if sales are controlled, then the denominator of the balance sheet ratio should not be sales) (3) a short term interest rate should be used, and (4) an interest factor (i/(1+i))[10] rather than a rate (i) should be used in the adjustments for receivables and payables.

Less frequently seen but still potentially important in some cases is the adjustment for differences in relative levels of PP&E between a tested entity and the comparables. Ideally, comparables and the entity being tested will have fairly similar relative levels of PP&E, since major differences can be a sign of fundamentally different functions and risks. In other cases, however, differences in relative levels of PP&E can indicate more of a buy-or-lease difference, variations in the age of assets, or capital-labor choices rather than any functional difference between the companies. In these cases, adjustments similar to those for receivables, inventories, and payables have been made. The PP&E adjustment has, however, been made using a longer term interest rate than the short term rates used for the other balance sheet adjustments.

Additional adjustments, used much more infrequently, include those for differences in other balance sheet items, operating expenses, R&D, or currency risk.[11] In rare or singular cases, there also have been adjustments for start-up costs, cost of capital variations, non-routine intangibles, sales shocks, manufacturing functions, and product liability. These adjustments have been evaluated on a case by case basis and made only when doing so improved the reliability of the results. Finally, accounting adjustments, such as reclassifying items from cost of goods sold to operating expenses, for example, have also been made when warranted to increase reliability. Often, data has not been available for both the controlled and uncontrolled transactions in sufficient detail to allow for these types of adjustments.

NATURE OF RANGES AND ADJUSTMENT MECHANISMS

(Sections 521(b)(2)(D)(viii) and (ix))

The types of ranges used in existing APAs are set forth in Table 16 below:

TABLE 16
TYPES OF RANGES

Type of Range	Number of APAs That Involve This Type
Full range	5
Interquartile range	41
Interquartile range recomputed after Tukey filter	5
Agreed range	11
Floor (result must be no less than x)	20
Ceiling (result must be no more than x)	4
Specific result	144
Financial products - statistical confidence interval to test for internal CUP	16

DISCUSSION

Reg. § 1.482–1(e)(1) of the transfer pricing regulations states that sometimes a pricing method will yield "a single result that is the most reliable measure of an arm's length result." Sometimes, however, a method may yield "a range of reliable results," called the "arm's length range." A taxpayer whose results fall within the arm's length range will not be subject to adjustment.

Under Reg. § 1.482–1(e)(2)(i), such a range is normally derived by considering a set of more than one comparable uncontrolled transaction,[12] of similar comparability and reliability. If these comparables are of very high quality, as defined in the Regulations,[13] then under Reg. § 1.482–1(e)(2)(iii)(A) the arm's length range includes the results of all of the comparables (from the least to the greatest). However, the APA Program has only rarely identified cases meeting the requirements for the full range. If the comparables are of lesser quality, then under

[9] The formulas in Appendix B do not represent the formal IRS position on adjustments. Rather, they are examples of adjustment mechanisms that have been used by the APA Program.

[10] This factor may have the holding period incorporated into it.

[11] See above for a discussion of currency risk.

[12] The term "transaction" here can include many transactions by one company, considered on an aggregate basis. See Reg. § 1.482-1(f)(2)(iv) (product lines).

[13] For such comparables, "it is likely that all material differences have been identified" between the uncontrolled comparables and the controlled transaction. Further, each identified difference has "a definite and reasonably ascertainable effect on price or profit, and an adjustment is made to eliminate the effect of each such difference." Reg. § 1.482-1(e)(2)(iii)(A).

Reg. § 1.482–1(e)(2)(iii)(B) "the reliability of the analysis must be increased, where it is possible to do so, by adjusting the range through application of a valid statistical method to the results of all of the uncontrolled comparables." One such method, the "interquartile range," is "ordinarily . . . acceptable," although a different statistical method "may be applied if it provides a more reliable measure." The "interquartile range" is defined as, roughly, the range from the 25th to the 75th percentile of the comparables' results. (A precise definition is given in Reg. § 1.482–1(e)(2)(iii)(C).) In the case of bilateral APAs, other methods for setting a range have been agreed upon as a result of compromise negotiations between the Competent Authorities.

A variant on the interquartile range involves a "Tukey filter," as follows. First, the set of comparables is used to derive a standard interquartile range. Then the difference D between the top and bottom of the interquartile range is computed. Next, all comparables whose results are more than a certain multiple of D (often the multiple 1.5 is used) outside the interquartile range are discarded as "outliers." Finally, the reduced set of comparables (without the outliers) is used to compute a second interquartile range, which is then used as the arm's length range. This approach has only occasionally been used for APAs (see Table16). The Tukey filter has been used to eliminate companies that were so anomalous that they arguably should not have been included as comparables in the first place.

Many times, even though a set of comparables could yield a range of results, APAs have specified a single or specific result, also called a "point." This approach was used in some APAs to avoid the possibility of manipulation to produce a result near the bottom of a specified range. For bilateral APAs, each country might be concerned about the potential for such manipulation, making it easier for the two countries to agree on a specific result than on a range. In many APAs, the specific point has been the median point of the set of comparables' results. However, in some APA cases arguments for a different point have been made and accepted.

APAs have often used a point in establishing a royalty rate. A set of comparables may yield a range of possible arm's length royalty rates. However, as a matter of business practice, companies typically fix precise royalty rates in advance. Therefore, APAs often require a specific royalty rate.

APAs also have tended to adopt a point rather than a range when applying profit split methods. In a comparable profit split under Reg. §1.482–6(c)(2), total profit is split in the same ratio as the profit of comparable uncontrolled parties is split. Typically this method produces a specific ratio of profit split, although if more than one set of comparable parties were used it would be possible to derive a range. In a residual profit split under Reg. § 1.482–6(c)(3), each party is first assigned a routine return, and any residual profit or loss is split according to each party's relative contribution to pertinent intangible property. As normally implemented, this method has yielded a specific result for both routine returns and the split of the residual profit, although in some cases it would be possible to derive ranges. Other methods in which a point rather than a range has been used include CUP, resale price, and cost plus. Sometimes only one comparable transaction is used,[14] yielding a specific result rather than a range. However, in some cases APAs have specified a modest range around the specific result, to accommodate changing business practices and conditions.

Some APAs specify not a point or a range, but a "floor" or a "ceiling." When a floor is used, the tested party's result must be greater than or equal to some particular value. When a ceiling is used, the tested party's result must be less than or equal to some particular value. Such an approach has been used, for example, where the TPM is a CPM with OM as the PLI and the comparable transactions reflect certain current business conditions that might improve. The APA required that the tested party's operating margin should always be above the bottom of the interquartile range, but that the operating margin could go above the top of the interquartile range if conditions improved.

[14] The use of only one comparable transaction is more likely when that transaction is an "internal" comparable uncontrolled transaction, that is, a transaction that involves one of the related parties under evaluation.

Some APAs involving financial products have employed a "statistical confidence interval" to compare pricing of a large set of controlled transactions with a comparable set of uncontrolled transactions. An example is a financial institution with fairly autonomous branches in several countries. Pursuant to the business profits article of the applicable income tax treaties and Prop. Reg. § 1.482–8(b), APAs have been executed allowing the taxpayer to allocate profits between branches with reference to the branches' internal accounting methods, taking into account all trades, including interbranch and/or interdesk trades. In order for this method to provide a reliable result, however, it is necessary to ensure that all such controlled trades be priced on the same market basis as uncontrolled trades. To test whether this is so, a branch's controlled trades are matched with that branch's comparable uncontrolled trades made at times close to the controlled trades. A statistical test is performed to detect pricing bias, by which the controlled trades might as a whole be priced higher or lower than the uncontrolled trades. This has been accomplished by construction of a statistical "confidence interval" (typically 95%), with the tested hypothesis being that controlled trades are priced on the same basis as uncontrolled trades. An adjustment is necessary if the results of the controlled trades fall outside of this confidence interval.

Adjustments

Under Reg. § 1.482–1(e)(3), if a taxpayer's results fall outside the arm's length range, the Service may adjust the result "to any point within the arm's length range." Accordingly, an APA may permit or require a taxpayer and its related parties to make an adjustment after the year's end to put the year's results within the range, or at the point, specified by the APA. Similarly, to enforce the terms of an APA, the Service may make such an adjustment. Where the APA specifies a range, the adjustment is sometimes to the closest edge of the range, and sometimes to another point such as the median of the interquartile range. Depending on the facts of each case, such automatic adjustments are not always permitted. Some APAs specify that if a tax-

payer's results fall outside the applicable point or range, the APA will be canceled or revoked. Some bilateral APAs specify that in such a case there will be a negotiation between the Competent Authorities involved to determine whether and to what extent an adjustment should be made. Some APAs permit automatic adjustments unless the result is far outside the range specified in the APA. Thus they provide flexibility and efficiency (permitting adjustments when normal business fluctuations and uncertainties push the result somewhat outside the range), while guarding against abuse of the adjustment mechanism.

In order to conform the taxpayer's books to these tax adjustments, the APA usually permits a "compensating adjustment" as long as certain requirements are met. Such compensating adjustments may be paid between the related parties with no interest, and the amount transferred will not be considered for purposes of penalties for failure to pay estimated tax.

TERM LENGTHS
(Section 521(b)(2)(D)(x))

The various term lengths for existing APAs are set forth in Table 17 below:

TABLE 17
TERMS OF APAs

Term in Years[15]	Number of APAs With This Term
1	2
2	11
3	48
4	48
5	93
6	20
7	6
8	3
9	1
10	2

Section 521(b)(2)(D)(x) requires that the report on term lengths include rollback years (*i.e.*, prior years to which the APA TPM is applied in order to resolve the same or similar transfer pricing issue for those earlier years) . Rollbacks, however, are not under the jurisdiction of the APA Program, but rather of the District Director bearing responsibility for examination of the taxpayer. Accordingly, rollback years are not included in or covered by the APA, and the APA Program office has not systematically tracked rollbacks. In some cases, the APA Program may not be informed whether a rollback of the APA methodology has been applied to back years, as that decision may be made after the APA is executed and closed by the Chief Counsel's office. For the future, the APA Program intends as part of IRS modernization to implement procedures for better coordination of rollbacks with the examination function.

Due to the foregoing, the APA Program is unable to provide complete information about rollbacks in this report. In 1999, however, as part of an unrelated project, the APA Program surveyed the Districts that had participated in APAs in an attempt to determine how and to what extent rollbacks had been applied. The results of that survey are summarized in Table 18 below:

TABLE 18
APA ROLLBACKS

	Number of Cases
Number of APA cases as of August 23, 1999	194
Cases with a rollback and number of rollback years per case:	50
1 year	5
2 years	3
3 years	10
4 years	12
5 years	8
6 years	7
7 years	2
8 years	1
9 years	1
16 years	1
Cases in which the APA process facilitated a settlement of back years, though the methodology was not rolled back	11

NATURE OF DOCUMENTATION REQUIRED
(Section 521(b)(2)(D)(xi))

One significant component of any APA agreement is the requirement that a taxpayer demonstrate compliance with the agreed-upon TPM or, alternatively, that any adjustment required by the TPM is accurately calculated. To accomplish this objective, the APA agreement includes documentation requirements, which are found in Section 5 (Financial Statements and APA Records) and Section 8 (Annual Report) of the model APA.

The APA agreement generally provides in part that "[t]he determination whether a taxpayer has complied with this APA will be based on its United States income tax return; its financial statements as prepared in accordance with generally accepted accounting principles ('GAAP') on a consistent basis (the 'Financial Statements'); the additional records ('APA Records') specified in Appendix B; and all information referenced in section 8 of this APA." The agreement also generally states that a "Taxpayer shall file a timely Annual Report for each APA Year pursuant to the rules of section 11.01 of Rev. Proc. 96–53."

Typically, the APA requires a taxpayer to demonstrate compliance with the agreed-upon TPM by providing the following documents in such an annual report:

1. A statement identifying all material differences between the Taxpayer's business operations, functions performed, risks assumed, and assets employed during the APA Year and the description of the Taxpayer's business operations as contained in Taxpayer's request for this APA or, if there have been no such material differences, a statement to that effect.
2. A statement identifying all relevant and material changes in the Taxpayer's accounting methods and classifications from those described or used in Taxpayer's request for this APA or, if there have been no such material changes, a statement to that effect.
3. The Taxpayer's Financial Statements for the APA Year as prepared in accordance with U.S. GAAP.
4. A financial analysis demonstrating Taxpayer's compliance with the

[15] Partial tax years and short full tax years are both counted as full years.

TPM including a computation of the TPM amount and a reconciliation of the TPM amount to the financial statements.

5. A description of any failure to meet Critical Assumptions or, if there have been no such failures, a statement to that effect.
6. A description of the reason for, and financial analysis of, any Compensating Adjustments with respect to the APA Year, including the means by which any such Compensating Adjustment has been or will be satisfied.
7. A copy of the certified public accountant's opinion described in section 5 of this APA for the APA Year.

The documentation provisions referred to above are necessary to establish whether a taxpayer has complied with the agreed-upon TPM, including whether any adjustment required to bring the taxpayer into compliance with the TPM is accurately calculated. Under the APA, a taxpayer must retain all documents required to be included in the annual report, as well as all work papers, records, or other documents that support the information provided in such documents. Compliance by a taxpayer with the APA documentation provisions also constitutes compliance with the record maintenance requirements of Sections 6038A and 6038C of the Internal Revenue Code with respect to the covered transactions during the APA term.

The documentation provisions generally require a taxpayer to submit audited financial statements for the APA Year prepared in accordance with U.S. GAAP. The IRS relies on audited financial statements – as opposed to unaudited financial statements – because they contain an unqualified opinion by an independent accountant that the Taxpayer's financial condition is fairly presented. Audited financial statements also represent the company's financial condition as it is presented to shareholders and the public. Additionally, audited financial statements prepared in accordance with GAAP ensure that a taxpayer's financial operations are reflected based on known accounting principles.

In addition to the requirements identified above, APA agreements may also require documentation tailored to specific industries. For example, the nature of records kept by taxpayers engaged in the financial products business often differs from that of taxpayers in other industries. Therefore financial products APAs would have record keeping requirements tailored to that industry. For example, such APAs might typically require some or all of the following additional documents:

(1) annual profit & loss statements of the U.S. taxpayer;
(2) summaries of currencies used to account for payments or allocations to parent or head office;
(3) leave order confirmations;
(4) daily revaluation reports;
(5) historical pricing data for currency transactions;
(6) schedule of costs of hedging contracts; and
(7) historical market quotations.

The documents outlined above support transactions that are specific to financial product APAs, such as hedging transactions and the allocation of global trading expenses.

APAs covering cost sharing arrangements may also generate additional documentation requirements, such as requiring a taxpayer to provide:

(1) amendments to cost sharing or technology license agreement;
(2) summaries of each product included in cost sharing agreement;
(3) reconciliations of R&D costs to cost sharing payments, including invoices for cost sharing payments;
(4) lists of affiliates included and excluded in each cost sharing group;
(5) summaries of intangibles that each affiliate brings to the cost sharing agreement; and
(6) internal documents relied upon in calculating the annual cost sharing payment.

These additional requirements are intended to document transactions germane to cost sharing arrangements, including the buy in and buy out payments related to existing and work-in-progress R&D, the expenses comprising the cost pool, as well as the allocation of those expenses to the participating members of the cost sharing arrangement.

Finally, the documentation provisions of an APA can be tailored to address a taxpayer's specific business or specific accounting system. For example, some APAs have required a taxpayer to document sales from specific product lines or to compile sales and expense data for specific factories. In this situation, the information sought might be used to evaluate the financial results or the functions performed by a specific affiliate in a consolidated group. Along the same lines, information regarding a company's worldwide ratio of R&D expenses to sales may shed light on the R&D functions being performed by a domestic subsidiary as compared to a foreign parent.

Alternatively, some annual reports have required information such as third party royalty agreements, which would be used to support a CUT analysis, and U.S. Customs filings, if there is an issue regarding the inconsistent valuation of imported tangible property. Some APAs have also required a taxpayer's business plan or a reconciliation of financial projections with actual financial results to ascertain whether the financial projections that formed the basis for the TPM approximated the actual financial results.

Other types of required documents may include the production of IRS Forms 5471 and 5472 (Information returns outlining transactions between controlled parties) and IRS Form 3115 (Information return outlining changes in accounting methods). Taxpayers may also be required to explain extraordinary transactions with a foreign parent that exceed a certain dollar limitation.

The type of information described above is necessary in evaluating whether there have been changes to a taxpayer's business or accounting methods that could have a material impact on the application of the TPM. Through the APA documentation requirements, the Service can ensure taxpayer compliance with the agreed-upon TPM or, alternatively, the need for an accurate calculation of any adjustment designed to bring a taxpayer into compliance.

EFFORTS TO ENSURE COMPLIANCE WITH APAs

(Section 521(b)(2)(F))

As described above in "Nature of Documentation Required," each APA contains documentation provisions, based on the facts of that case, designed to enable the Service to ensure compliance with the

TPM and other terms of the APA. As part of these provisions, the taxpayer is required to file an annual report demonstrating compliance with the APA for each covered APA year, and putting the Service on notice if critical assumptions have been violated or material facts have changed.

When the annual report is received by the APA Program, it is reviewed by a member of the professional staff. One Team Leader has been assigned the lead role in this review, and is responsible not only for reviewing most of the annual reports received by the APA Program office, but also for maintaining a database that tracks the annual reports required by each APA to ensure that taxpayers are complying with their obligation to file the reports in a timely manner. At times, another member of the APA staff will be responsible for the initial review of a given annual report, for example, the team leader who negotiated the APA in question if the level of complexity makes it more efficient for a person already familiar with the case to review the report; or a request to renew the APA to which the annual report relates might be in process, in which case the team leader assigned the renewal might be assigned the annual report for similar reasons of efficiency.

The APA Program reviews the annual report to make sure that the information required is included in the report, and to determine whether the taxpayer has, on the face of the report, complied with the terms of the APA, including proper application of the TPM. For the most part, the APA Program does not attempt to audit the accuracy of the numbers contained in the report, but will look at issues such as proper classification of expenses. If this review determines that there is a question as to whether the taxpayer is in compliance, the APA Program (in coordination with the relevant District) will contact the taxpayer to discuss the issue and request further information, as necessary. If the APA Program's review does not detect any problems on the face of the annual report, the report is forwarded to the District with examination jurisdiction over the taxpayer – typically, the District that participated in the APA negotiations. The District is responsible for deciding whether or to what extent to audit the underlying data, for example, substantiating expenses or reviewing allocations used by the taxpayer in arriving at the conclusion that it complied with the APA.

To date, this multifunctional review procedure has indicated that taxpayers comply with the requirements of the APA in the great majority of cases. As of December 31, 1999, out of 239 annual reports that had been reviewed, the Service had identified proposed adjustments to taxable income with respect to fifteen APAs. Such adjustments totaled approximately $132 million, though in some cases these amounts have not been agreed to by the taxpayers.

Appendix A

MODEL ADVANCE PRICING AGREEMENT

ADVANCE PRICING AGREEMENT
between
TAXPAYER
and

THE INTERNAL REVENUE SERVICE

ADVANCE PRICING AGREEMENT
between
TAXPAYER
and

THE INTERNAL REVENUE SERVICE

THIS ADVANCE PRICING AGREEMENT ("APA") is made by and between Taxpayer and the Internal Revenue Service ("Service"), acting through the Associate Chief Counsel (International).

WHEREAS, Taxpayer and the Service (the "Parties") wish to establish a method for determining whether certain prices used in international transactions involving Taxpayer are in accordance with the principles of section 482 of the Internal Revenue Code of 1986 as amended (the "Code") and attendant Regulations and, to the extent applicable, income tax conventions to which the United States is a party;

NOW, THEREFORE, in consideration of the mutual promises contained herein, the Parties agree as follows:

1. *Identifying information*. Taxpayer's EIN is _____. [Taxpayer is included in the consolidated federal income tax return filed by _____, EIN _____. All references to Taxpayer's United States income tax return in this APA refer to that consolidated return, and all references in this APA to "Taxpayer" shall refer to the _____ consolidated return group.]

2. *Covered transactions*. This APA governs the pricing of the transactions specified in Appendix A (the "Covered Transactions").

3. *Legal Effect.*

3.1. Taxpayer agrees to comply with the terms and conditions of this APA, including the transfer pricing methodology ("TPM") that is described in Appendix A. If Taxpayer complies with the terms and conditions of this APA, then the Service will not contest the application of the TPM to the Covered Transactions and will not make or propose any reallocation or adjustment under section 482 of the Code with respect to Taxpayer concerning the transfer prices in Covered Transactions for the years covered by this APA (the "APA Years").

3.2. Regardless of the date on which Taxpayer filed its request for this APA, Taxpayer and the Service agree, unless otherwise specified to the contrary in this APA, that Rev. Proc. 96–53, 1996–2 C.B. 375, and not any predecessor to Rev. Proc. 96–53, governs the interpretation, administration, and legal effect of this APA.

3.3. If, for any APA Year, Taxpayer does not comply with the terms and conditions of this APA, then the Service may:

i. enforce the terms of this APA and propose adjustments to the income, expenses, deductions, credits, or allowances reported on Taxpayer's U.S. federal income tax return in keeping with the terms of this APA;

ii. cancel or revoke this APA pursuant to section 11.05 or 11.06 of Rev. Proc. 96–53; or

iii. revise this APA, upon agreement on revision with Taxpayer.

3.4. [This APA addresses the arm's length nature of prices charged or received in the aggregate between Taxpayer and [name of foreign group], and except as explicitly provided in this APA does not address, and does not bind the Service with respect to, prices charged or received, or the relative amounts of income or loss realized, by particular legal entities that are members of Taxpayer or that are members of [foreign group]. The true taxable income of a member of an affiliated group filing a U.S. consolidated return shall be determined under the regulations governing consolidated returns. *See, e.g.*, Treas. Reg. section 1.1502–12. Similarly, to the extent relevant for United States tax purposes, and except as explicitly provided in this APA, the relative amounts of income of different entities that are members of [foreign group] shall be determined under the arm's length standard of section 482 without reference to this APA.]

3.5. The Parties agree that nonfactual oral and written representations, within the meaning of sections 10.04 and 10.05 of Rev. Proc. 96–53 (including any proposals to use particular TPMs), made in conjunction with this request constitute statements made in compromise negotiations within the meaning of Rule 408 of the Federal Rules of Evidence.

4. *Term*. This APA shall apply only to the APA Years, which shall include only _____.

5. *Financial Statements and APA Records*. The determination whether Taxpayer has complied with this APA will be based on its United States income tax return; its financial statements as prepared in accordance with generally accepted accounting principles ("GAAP") on a consistent basis (the "Financial Statements"); the additional records ("APA Records") specified in Appendix B; and all information specified in section 8 of this APA. Taxpayer will not be in compliance with the TPM unless an independent certified public accountant renders an opinion that the Financial Statements present fairly, in all material respects, the financial position of Taxpayer and the results of its operations, in accordance with GAAP. Taxpayer agrees to maintain the Financial Statements and APA

Records and to make them available within thirty days of a request by the Service in connection with an examination described in section 11.03 of Rev. Proc. 96–53. Compliance with this section 5 of the APA will constitute compliance with the provisions of sections 6038A and 6038C of the Code, with respect to Covered Transactions during the APA Years.

6. *Critical Assumptions*. The Critical Assumptions of this APA, within the meaning of section 5.07 of Rev. Proc. 96–53, are listed in Appendix C.

7. *Tax and Compensating Adjustments*. In the event Taxpayer's actual transactions did not result in compliance with the TPM described in Appendix A, Taxpayer's taxable income must nevertheless be reported in an amount consistent with the TPM and the requirements of the APA, either on a timely filed original return or on an amended return. Taxpayer may make Compensating Adjustments as described in and subject to the rules of section 11.02 of Rev. Proc. 96–53, and subject to any restrictions stated in this APA.

8. *Annual Report*. Taxpayer shall file a timely Annual Report for each APA Year pursuant to the rules of section 11.01 of Rev. Proc. 96–53. The Annual Report shall contain the information described in Appendix D. In connection with an examination described in section 11.03 of Rev. Proc. 96–53, the District Director may request and Taxpayer shall provide additional facts, computations, data or information reasonably necessary to clarify the Annual Report or verify compliance with the APA.

9. *Disclosure*. This APA, and the information, data, and documents related to this APA and Taxpayer's APA request are: (1) considered "return information" pursuant to section 6103(b)(2)(C) of the Code; and (2) not subject to public inspection as a "written determination" pursuant to section 6110(b)(1) of the Code. Pursuant to section 521 of the Tax Relief Extension Act of 1999, however, the Secretary of the Treasury is obligated to prepare a report for public disclosure that would include certain specifically designated information concerning all APAs, including this APA, in such form as not to reveal taxpayers' identities, trade secrets, and proprietary or confidential business or financial information.

10. *Disputes*. Should a dispute arise concerning the interpretation of this APA, the Parties agree to seek resolution of the dispute by the Associate Chief Counsel (International), to the extent reasonably practicable, prior to seeking alternative remedies. Disputes not related to the interpretation of this APA shall be pursued consistent with section 11.03(4) of Rev. Proc. 96–53.

11. *Section Captions*. The section captions contained in this APA are for convenience and reference only and shall not affect in any way the interpretation or application of this APA.

12. *Notice*. Any notices required by this APA or Rev. Proc. 96–53 shall be in writing. Taxpayer shall send notices to the Service at the address and in the manner prescribed in section 5.13(2) of Rev. Proc. 96–53. The Service shall send notices to Taxpayer at _____.

13. *Effective date*. This APA shall become binding when both Parties have executed the APA [,and the competent authorities of _____ and the United States have executed a mutual agreement that is consistent with this APA].

14. *Counterparts*. This APA may be executed in counterparts, with each counterpart deemed an original.

IN WITNESS WHEREOF, the Parties have executed this APA on the dates indicated below.

TAXPAYER

By: _____ Date: _____

[Name of Signature]

[Title]

INTERNAL REVENUE SERVICE

By: _____ Date: _____

[Name of Signature]

[Deputy] Associate Chief Counsel (International)

APPENDIX A
TRANSFER PRICING METHODOLOGY

For each APA Year:

H. ***Covered Transactions.***

The Covered Transactions for this APA consist of _____.

I. ***Transfer Pricing Methodology ("TPM").***

APPENDIX B
APA RECORDS

1. All documents listed in Appendix D for inclusion in the Annual Report, as well as all documents, notes, work papers, records, or other writings that support the information provided in such documents.

2. [Insert here other records.]

APPENDIX C
CRITICAL ASSUMPTIONS

1. The business activities, functions performed, risks assumed, assets employed, and financial [and tax] accounting methods and classifications [and methods of estimation] of Taxpayer shall remain materially the same as described or used in Taxpayer's request for this APA.
2. [Insert here other Critical Assumptions.]

APPENDIX D
ANNUAL REPORT

Taxpayer shall include the following in its Annual Report for each APA Year:

1. A statement identifying all material differences between Taxpayer's business operations (including functions performed, risks assumed and assets employed) during the APA Year and the description of the same contained in Taxpayer's request for this APA, or if there have been no such material differences a statement to that effect.
2. A statement identifying all material changes in Taxpayer's accounting methods and classifications [and methods of estimation] from those described or used in Taxpayer's request for this APA, or if there have been no such material changes a statement to that effect.
3. The Financial Statements.
4. A financial analysis demonstrating Taxpayer's compliance with the TPM.
5. A description of any failure to meet Critical Assumptions, or if there have been no such failures, a statement to that effect.
6. A description of the reason for, and financial analysis of, any Compensating Adjustments with respect to the APA Year, including the means by which any such Compensating Adjustment has been or will be satisfied.
7. A copy of the certified public accountant's opinion, described in section 5 of this APA, for the APA Year.
8. [Insert here other items to be included in Annual Report.]

Appendix B
FORMULAS FOR BALANCE SHEET ADJUSTMENTS

Definitions of Variables:

AP = average accounts payables
AR = average trade receivables, net of allowance for bad debt
cogs = cost of goods sold
INV = average inventory, stated on FIFO basis
opex = operating expenses (general, sales, administrative, and depreciation expenses)
PPE = property, plant, and equipment, net of accumulated depreciation
sales = net sales

h = average holding period, stated as a fraction of a year (for AP or AR)
i = interest rate

$_t$ = entity being tested
$_c$ = comparable

Equations:

If Cost of Goods Sold is controlled (generally, sales in denominator of PLI):

Receivables Adjustment ("RA"): $RA = \{[(AR_t / sales_t) \times sales_c] - AR_c\} \times \{i/[1+(i \times h_c)]\}$
Payables Adjustment ("PA"): $PA = \{[(AP_t / sales_t) \times sales_c] - AP_c\} \times \{i/[1+(i \times h_c)]\}$
Inventory Adjustment ("IA"): $IA = \{[(INV_t / sales_t) \times sales_c] - INV_c\} \times i$
PP&E Adjustment ("PPEA"): $PPEA = \{[(PPE_t / sales_t) \times sales_c] - PPE_c\} \times i$

If Sales are controlled (generally, costs in the denominator of PLI):[16]

[16] Depending on the specific facts, the equations below may use cost of goods sold as shown or total costs, which is defined as (cogs + opex).

Receivables Adjustment ("RA"): $RA = \{[(AR_t / cogs_t) \times cogs_c] - AR_c\} \times \{i/[1+(i \times h_c)]\}$
Payables Adjustment ("PA"): $PA = \{[(AP_t / cogs_t) \times cogs_c] - AP_c\} \times \{i/[1+(i \times h_c)]\}$
Inventory Adjustment ("IA"): $IA = \{[(INV_t / cogs_t) \times cogs_c] - INV_c\} \times i$
PP&E Adjustment ("PPEA"): $PPEA = \{[(PPE_t / cogs_t) \times cogs_c] - PPE_c\} \times i$

then:

adjusted $sales_t = sales_t + RA$
adjusted $cogs_t = cogs_t + PA - IA$
adjusted $opex_t = opex_t - PPEA$

Subchapter S Subsidiaries; Correction

Announcement 2000–36

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8869, 2000-6 I.R.B. 498) which were published in the **Federal Register** on Tuesday, January 25, 2000 (65 FR 3843), relating to the treatment of corporate subsidiaries of S corporations and interpret the rules added to the Internal Revenue Code by section 1308 of the Small Business Job Protection Act of 1996.

DATES: This correction is effective January 25, 2000.

FOR FURTHER INFORMATION CONTACT: Jeanne M. Sullivan at (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under sections 1361, 1362, and 1374 of the Internal Revenue Code.

Need for Correction

As published, the final regulations (T.D. 8869) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8869), which were the subject of FR Doc. 00-1718, is corrected as follows:

1. On page 3845, column 1, under the caption "**Explanation of Provisions**", line 14 from the top of the column, the language, "2 I.R.B.1, which provides that the" is corrected to read "2 I.R.B. 288, which provides that the".

2. On page 3845, column 1, the caption "b. QSUB Termination" is corrected to read "b. QSub Termination".

§1.1361–4 [Corrected]

3. On page 3852, column 2, §1.1361–4(d) *Example 3*, line 15, the language, "2000, the day after the acquisition date" is corrected to read "2002, the day after the acquisition date".

§1.1361–5 [Corrected]

4. On page 3853, column 1, §1.1361–5(b)(1)(i), line 9, the language, "corporation. he tax treatment of this" is corrected to read "corporation. The tax treatment of this".

§1.1362–8 [Corrected]

5. On page 3855, column 3, §1.1362–8(d) *Example 2*(ii), line 1, the language, "(ii) Four-fifths ($12,000/15,000) of the" is corrected to read "(ii) Four- fifths ($12,000/$15,000) of the".

6. On page 3855, column 3, §1.1362–8(d) *Example 2*(ii), line 13, the language, "Under these facts, $41 ($920/1,900 of" is corrected to read " Under these facts, $41 ($920/$1,900 of".

Dale D. Goode,
Federal Register Liaison,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 27, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 28, 2000, 65 F.R. 16317)

Amortization of Intangible Property; Correction

Announcement 2000–37

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction of final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8865, 2000–7 I.R.B. 589) which were published in the **Federal Register** on Tuesday, January 25, 2000 (65 FR 3820), relating to the amortization of certain intangible property.

DATES: This correction is effective January 25, 2000.

FOR FURTHER INFORMATION CONTACT: John Huffman at (202) 622-3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The final regulations that are subject to these corrections are under sections 167 and 197 of the Internal Revenue Code.

Need for Correction

As published, the final regulations (TD 8865) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8865), which were the subject of FR Doc. 00–1380, is corrected as follows:

§1.197–2 [Corrected]

1. On page 3834, column 3, §1.197–2(g)(3), line 22, the language, "increase. The provisions of paragraph" is corrected to read "increase, except as provided in §1.743–1(j)(f)(i)(B)(*2*). The provisions of paragraph".

2. On page 3834, column 3, §1.197–2(g)(4)(i), lines 10 through 13,

the language, "either the curative or remedial allocation methods described in the regulations under section 704(c). See §1.704–3(c) and (d)" is corrected to read "any of the permissible methods described in the regulations under section 704(c). See §1.704–3".

3. On page 3834, column 1, §1.197–2(g)(4)(ii), line 6, the language, "the intangible is not amortizable by the" is corrected to read "the intangible is not amortizable under section 197 by the ".

4. On page 3839, column 3, §1.197–2(k) *Example 6*(i), third line from the top of the column, the language "consideration paid for all assets acquired in" is corrected to read "consideration paid excluding any amount treated as interest or original issue discount under applicable provisions of the Internal Revenue Code, for all assets acquired in".

5. On page 3839, column 3, §1.197–2(k) *Example 6*(ii), lines 15 through 18, the language, "Although the payments under the agreement ($270,000) exceed the amount allocated to the covenant by $45,000, all of the remaining consideration ($50,000) is allocated to Class" is corrected to read "All of the remaining consideration after allocation to the covenant and other Class VI assets, ($50,000) is allocated to Class".

6. On page 3839, column 3, §1.197–2(k) *Example 7*(ii), line 7, the language, "amecause it does not have a term of less than" is corrected to read "amount because it does not have a term of less than".

7. On page 3843, column 1, §1.197–2(k) *Example 27*(i), lines 4 and 5, the language, "which A owns a 60-percent, and B owns a 40-percent, interest in profits and capital. A" is corrected to read "which A owns a 40-percent, and B owns a 60-percent, interest in profits and capital. A"

8. On page 3843, column 2, §1.197–2(l)(4)(iii), line 14, the language, "before a federal court, the taxpayer must" is corrected to read " before a Federal court, the taxpayer must".

Dale D. Goode,
Federal Register Liaison,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 27, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 28, 2000, 65 F.R. 16318)

Financial Asset Securitization Investment Trusts; Real Estate Mortgage Investments Conduits; Correction

Announcement 2000–38

This document contains a correction to proposed regulations (REG–100276–97, 2000–8 I.R.B. 682), relating to financial asset securitization investment trusts (FASITs) and real estate mortgage investment conduits (REMICs).

In the title to the document, the citation of the proposed regulation number "REG–100276–97" is incorrect. The correct citation should read as follows:

"REG–100276–97; REG–122450–98".

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

Announcement 2000–39

The name of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

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

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on April 17, 2000, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428 (c)(1). For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Aguila Improvement Association, Inc.
Aguila, AZ
Arizona Educational Enrichment Trust
Phoenix, AZ
Central Arizona Charitable Trust
Phoenix, AZ
Liberation Collective
Portland, OR
Peoria Charitable Trust
Phoenix, AZ
Southern California Institute, Inc.
Loma Linda, CA
WorkAmerica, Inc.
Pomoroy, OH

Taxation of Tax-Exempt Organizations' Income From Corporate Sponsorship; Correction

Announcement 2000–40

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to proposed regulations (REG–209601–92, 2000–12 I.R.B. 829), which were published in the **Federal Register** on Wednesday, March 1, 2000 (65 FR 11012), relating to the tax treatment of sponsorship payments received by exempt organizations.

FOR FURTHER INFORMATION CONTACT: Stephanie Lucas Caden at (202) 622-6080.

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations that are the subject of this correction are under section 512 of the Internal Revenue Code.

Need for Correction

As published, the proposed regulations [REG–209601–92] contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the proposed regulations [REG–209601–92], which were the subject of FR Doc. 00–4848, is corrected as follows:

1. On page 11012, third column, in the preamble, the last sentence under the caption ADDRESSES is corrected to read, "The public hearing will be held in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.".

2. On page 11012, third column, in the preamble, the text under the caption FOR FURTHER INFORMATION CONTACT is corrected to read, "Concerning the regulations, Stephanie Lucas Caden at (202) 622–6080; concerning submissions and the hearing, LaNita VanDyke at (202) 622-7180 (not toll-free numbers).".

3. On page 11015, second column, the first sentence of the second paragraph under the caption **Comments and Public Hearing** is corrected to read, "A public hearing has been scheduled for June 21, 2000, at 10 a.m. in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.".

§1.513–4 [Corrected]

4. On page 11018, third column, in the 22nd line of §1.513–4(f) *Example 8*, the language "Music Shop's name and address in the lobby" is corrected to read, "Music Shop's name, address and telephone number in the lobby".

Dale D. Goode,
Federal Register Liaison,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on April 4, 2000, 8:45 a.m., and published in the issue of the Federal Register for April 5, 2000, 65 F.R. 17829)

Qualified Transportation Fringe Benefits; Correction

Announcement 2000–41

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to the notice of proposed rulemaking.

SUMMARY: This document contains corrections to proposed regulations (REG–113572–99, 2000–7 I.R.B. 624) which were published in the Federal Register on Thursday, January 27, 2000 (65 F.R. 4388), relating to qualified transportation fringe benefits.

FOR FURTHER INFORMATION CONTACT: John Richards at (202)622-6040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The proposed regulations that are the subject of these corrections reflect the changes to the law made by the Energy Policy Act of 1992, the Taxpayer Relief Act of 1997, and the Transportation Equity Act for the 21st Century.

Need for Correction

As published, this notice of proposed rulemaking contains errors in need of clarification.

Correction of Publication

Accordingly, the publication of the notice of proposed rulemaking (REG–113572–99), which was the subject of FR Doc. 00–1859, is corrected as follows:

§1.132–9 [Corrected]

1. On page 4392, column 2, §1.132–9(b), A-7, paragraph (d), line 3, the language "Q/A7" is corrected to read "Q-A-7".

2. On page 4293, column 1, §1.132–9(b), Q-11, line 2, the language "fringes be provided pursuant to a" is corrected to read "fringes be provided to employees pursuant to a".

3. On page 4393, column 3, §1.132–9(b), A-14, paragraph (d), line 4, the language "paragraph (a)(3) of the Q/A-14, an" is corrected to read "paragraph (c) of this Q/A-14, an".

4. On page 4395, column 1, §1.132–9(b), Q-16, paragraph (d)(2), line 8, the language "that it will be used it during the month." is corrected to read "that it will be used during the month.".

5. On page 4395, column 2, §1.1320–9(b), A-21, paragraph (a), line 2, the language "Employer-and" is corrected to read "Employer and".

6. On page 4395, column 2, §1.132–9(b), A-21, paragraph (b), line 8, the language "132(f)(5)(B) and Q/A2- of this section." is corrected to read "132(f)(5)(B) and Q/A-2 of this section.".

7. On page 4396, column 1, §1.132–9(b), A-22, paragraph (b), line 7, the language "monthly limit under section 132(f) are" is corrected to read "monthly limit under section 132(f) is".

8. On page 4396, column 3, the title of the official signing the document, "Commissioner of Internal Revenue" is corrected to read "Deputy Commissioner of Internal Revenue Service".

Dale D. Goode,
Federal Register Liaison,
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on March 28, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 29, 2000, 65 F.R. 16545)

Partial Withdrawal of Notice of Proposed Rulemaking Relating to Diesel Fuel Excise Tax; Dye Injection Systems

Announcement 2000–42

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Partial withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws the notice of proposed rulemaking as it relates to diesel fuel dye injection systems, which was published on March 14, 1996. It affects certain enterers, refiners, terminal operators, and throughputters.

FOR FURTHER INFORMATION CONTACT: Frank Boland, (202) 622-3130 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On March 14, 1996, the IRS issued proposed regulations (PS-6-95 [1996–1 C.B. 859]; REG–209753–95) relating to diesel fuel dye injection systems and the

measurement of taxable fuel (61 FR 10490). The Treasury Department does not have any plans at the present time to issue final regulations relating to dye injection systems.

* * * * *

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking as it relates to dye injection systems that was published in the **Federal Register** on March 14, 1996 (61 FR 10490) is withdrawn.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for March 31, 2000, 65 F.R. 17211)

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 law 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 the 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 Contribution 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.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
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