Internal Revenue
bulletin

Bulletin No. 2000–38
September 18, 2000

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8898, page 276.

Final regulations under section 368 of the Code relate to the continuity of interest requirement for certain corporate reorganizations.

T.D. 8901, page 272.

Final regulations under section 110 of the Code relate to an exclusion from gross income for qualified lessee construction allowances provided by a lessor to a lessee for the purpose of constructing long-lived property to be used by the lessee pursuant to a short-term lease.

Notice 2000–50, page 291.

2000 marginal production rates. This notice announces the applicable percentage under section 613A of the Code to be used in determining percentage depletion for marginal properties for the 2000 calendar year.

Notice 2000–51, page 291.

2000 enhanced oil recovery credit. The enhanced oil recovery credit for taxable years beginning in the 2000 calendar year is determined without regard to the phase-out for crude oil price increases provided in section 43(b) of the Code.

Notice 2000–52, page 292.

Electricity produced from certain renewable resources. This notice announces the calendar year 2000 inflation adjustment factor and reference prices for the renewable electricity production credit under section 45 of the Code.

Notice 2000–53, page 293.

SRLY election to avoid overlap rules. The Treasury Department and the Service intend to provide an election to allow a corporation that ceased to be a member of a consolidated group as a result of a qualified stock purchase to avoid the application of the overlap rules of sections 1.1502–15(g), 1.1502–21(g), and 1.1502–22(g) of the regulations while it was in that group.

EMPLOYEE PLANS

T.D. 8900, page 279.

Final regulations under section 411 of the Code permit qualified defined contribution plans to be amended to eliminate some alternative forms in which an account balance can be paid and permit certain transfers between defined contribution plans that were not previously permitted.

GIFT TAX

T.D. 8899, page 288.

Final regulations relate to the definition of a qualified interest under section 2702 of the Code.

Finding Lists begin on page ii.
Announcement of Disbarments and Suspensions begins on page 295.

Department of the Treasury
Internal Revenue Service

The IRS Mission

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

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

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

Section 110.—Qualified Lessee Construction Allowances for Short-Term Leases

26 CFR 1.110–1: Qualified lessee construction allowances.

T.D. 8901

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

Qualified Lessee Construction Allowances for Short-Term Leases

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations concerning an exclusion from gross income for qualified lessee construction allowances provided by a lessor to a lessee for the purpose of constructing long-lived property to be used by the lessee pursuant to a short-term lease. The final regulations affect a lessor and a lessee paying and receiving, respectively, qualified lessee construction allowances that are depreciated by a lessor as nonresidential real property and excluded from the lessee's gross income. The final regulations provide guidance on the exclusion, the information required to be furnished by the lessor and the lessee, and the time and manner for providing that information to the IRS.

DATES: *Effective Date*: These regulations are effective October 5, 2000.

Date of Applicability: For date of applicability of §1.110–1, see §1.110–1(d).

FOR FURTHER INFORMATION CONTACT: Paul Handleman, (202) 622-3040 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1661. Responses to these collections of information are mandatory.

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

The estimated annual burden per respondent varies from .5 hours to 1.5 hours, depending on individual circumstances, with an estimated average of 1 hour.

Comments concerning the accuracy of these burden estimates and suggestions for reducing these burdens should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, OP:FS:FP, Washington, DC 20224, and 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.

Books or records relating to this 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

On September 20, 1999, the IRS published proposed regulations (REG–106010–98, 1999–40 I.R.B. 493) in the **Federal Register** (64 F.R. 50783) inviting comments under section 110. A public hearing was held January 19, 2000. Numerous comments have been received. After consideration of all the comments, the proposed regulations are adopted as revised by this Treasury decision.

Public Comments

In accordance with section 110(a), the proposed regulations provided that amounts provided to a lessee by a lessor for property to be constructed and used by the lessee pursuant to a lease are not includible in the lessee's gross income if the amount is a qualified lessee construction allowance. The proposed regulations defined a qualified lessee construction allowance as any amount received in cash (or treated as a rent reduction) by a lessee from a lessor under a short-term lease of retail space, provided the purpose and expenditure requirements are met.

Expenditure Requirement

The proposed regulations required that a qualified lessee construction allowance be expended by the lessee in the taxable year received on the construction or improvement of qualified long-term real property for use in the lessee's trade or business at the retail space. However, the proposed regulations deemed an amount to have been expended by a lessee in the taxable year in which the construction allowance was received by the lessee if the amount is expended within 8 1/2 months after the close of that taxable year.

Several commentators maintained that the proposed rule prescribing a time limit for making the expenditure is not required by the statute or the legislative history and should be eliminated. One commentator, for example, pointed out the absence of an explicit expenditure requirement in section 110 like the one found in section 118(c)(2)(B), which requires that an expenditure relating to a nontaxable contribution in aid of construction be made before the end of the second taxable year after the year in which such amount was received.

Section 110 does not provide an explicit expenditure time limit, but it also does not toll the statute of limitations until the taxpayer notifies the Secretary that the amount has been expended as does section 118. The lack of a statute of limitation tolling provision in section 110 would be troublesome if there was no limitation on the time period to make the qualified expenditure. In addition, section 110(a) provides that an amount may be excluded only to the extent that such amount does not exceed the amount expended by the lessee for the construction or improvement of qualified long-term real property.

The IRS and Treasury Department believe that the absence of an extension of the statute of limitations and use of the term "expended" in the past tense indicate that the amount must be expended by the end of the taxable year it is received. Accordingly, the final regulations retain the expenditure time limitation. However, in recognition that a lessee may not be able to expend the amount in the same taxable year the lessee receives the construction allowance from the lessor, the final regulations also retain the 8 1/2 month rule provided in the proposed regulations. This 8 1/2 month rule, which grants the lessee an additional 8 1/2 months after the close of the taxable year in which the construction allowance was received to expend the amount, is consistent with the time period, including extensions, that a corporate taxpayer has to file its return for the taxable year in which the construction allowance is received.

Commentators requested that to the extent the final regulations retain the expenditure requirement, the requirement should be modified to include construction allowances used to reimburse lessee expenditures made in a prior year. In response to these comments, the final regulations clarify that, provided the lessee has not depreciated the expenditures, reimbursements received in a taxable year after the year in which the expenditures are made by the lessee are timely for purposes of the expenditure requirement.

Purpose Requirement

Consistent with section 110(a), the proposed regulations provided that a qualified lessee construction allowance must be under a short-term lease of retail space and for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at the retail space. The proposed regulations required that the lease agreement for the retail space expressly provide that the construction allowance is for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at that retail space. The purpose requirement was intended to further Congressional intent of ensuring consistency in the treatment of the construction allowance by both the lessor and the lessee.

Commentators suggested deleting the requirement in the proposed regulations that the lease agreement "expressly provides" that a construction allowance be for the purpose of constructing or improving qualified long-term real property. Other commentators suggested changing this language to "substantially provides" or using a standard that would lead a reasonable person to conclude that the purpose of the construction allowance amount is for the construction or improvement of qualified long-term real property. The final regulations do not adopt these suggestions. The IRS and the Treasury Department believe that this express language is consistent with the requirements of section 110(a) and is necessary to help ensure that the lessor and the lessee take consistent tax positions.

In addition, commentators noted that lease agreements do not necessarily address construction allowances. The construction allowance provisions may be contained in another document executed contemporaneously with the lease agreement or executed during the lease term. For example, the lessor may provide a construction allowance during the lease term for the remodeling of the retail space by the lessee. In response to these comments, the final regulations clarify that an ancillary agreement executed contemporaneously with the payment of a construction allowance, whether executed with the lease or during the term of the lease, is considered a provision of the lease agreement for this purpose.

Definition of Retail Space

Section 110(c)(3) defines the term "retail space" as real property leased, occupied, or otherwise used by a lessee in its trade or business of selling tangible personal property or services to the general public. The proposed regulations specifically requested comments on whether the definition of "retail space" needs to be clarified.

In response to comments, the final regulations clarify that offices for hair stylists, tailors, shoe repairmen, doctors, lawyers, accountants, insurance agents, financial advisors, stock brokers, securities dealers (including dealers who sell securities out of inventory), and bankers are included in the definition of retail space. The final regulations also clarify that a taxpayer is selling to the general public if the products or services for sale are made available to everyone even though only certain customers or clients are targeted.

A commentator suggested that retail space should include back-office support functions that are contiguous to the retail sales area and not be limited only to areas where customers purchase products and services. Section 110(c)(3) and the proposed regulations only require that the property be used "in the trade or business" of selling tangible personal property or services to the general public. In response to these comments, the final regulations state that the term "retail space" includes not only the space where the retail sales are made, but also space where activities supporting the retail activity are performed (such as an administrative office, a storage area, and an employee lounge).

Definition of Lease Term

Consistent with section 110(c)(2), the proposed regulations defined a short-term lease as a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined pursuant to section 168(i)(3)). Section 168(i)(3) provides rules on determining when renewal options will be considered part of the lease term. Section 168(i)(3)(B) provides that, in the case of nonresidential real property or residential rental property, any option to renew at fair market value, determined at the time of renewal, is not taken into account for purposes of determining the lease term.

A commentator suggested that the final regulations stipulate that certain common renewal options will be considered to be at fair market value. For example, the commentator suggested that if a lease sets rent at a certain percentage of sales for the original lease term and uses that same percentage of sales for renewal options, the renewals should be considered to be at fair market value. As the comment relates to the determination of lease term under section 168 and would affect other provisions in addition to section 110 that reference section 168(i)(3), such as sections 142 and 280F, the comment is beyond the scope of this regulation. Accordingly, the final regulations do not adopt the suggested comment.

Information Requirement

The proposed regulations required qualified lessee construction allowance information to be furnished by the lessor and the lessee to the IRS, and described the time and manner for providing that information to the IRS. The proposed regulations also provided that a lessor or a lessee that fails to furnish the required information may be subject to a penalty under section 6721.

A commentator suggested that the required information to be furnished should be the information that is current at the time the lease is executed. According to the commentator, it would not be unusual for a lease to be executed years prior to the payment and receipt of the construction allowance. One of the parties to the lease may have been acquired by another taxpayer or its name and address may have changed.

The final regulations do not adopt the suggestion. The purpose of the information reporting by the lessor and the lessee is to ensure consistent treatment of the construction allowance as nonresidential property owned by the lessor. Accordingly, it is imperative that the identity of the persons paying and receiving the construction allowance amount and relevant information provided be correct.

A commentator suggested that the information requirement should absolve the party filing the information statement from any penalty under section 6721 if the party relied upon incorrect information received from the other party or if the information cannot be obtained from the other party after reasonable efforts. Section 6724(a) provides that no penalty shall be imposed under section 6721 with respect to any failure if it is shown that such failure is due to reasonable cause and not willful neglect. Thus, no penalty under section 6721 will apply to a lessor (or a lessee) if the failure to furnish qualified lessee construction allowance information resulted from the lessee (or the lessor) providing incorrect information to the other party to the lease upon which the lessor (or the lessee) relied in good faith.

Another commentator suggested that the information to be furnished by a lessor is duplicative because the lessee is required to furnish the same information to the IRS. According to the commentator, the lessee should bear the entire burden of filing the required information because the lessee is the primary beneficiary of section 110. The final regulations do not adopt the commentator's suggestion. The information provided by the lessor is helpful in corroborating the information provided by the lessee and ensures that the lessor treats the amount as nonresidential real property on its return. Moreover, the reporting requirement in section 110(d) specifically provides that both the lessor and the lessee should furnish information.

Effective Date

The proposed regulations proposed an effective date applicable to leases entered into on or after the date final regulations are published in the **Federal Register**. A commentator suggested delaying the effective date of the final regulations to allow businesses a short period to conform their business practices to the final regulations. The final regulations adopt this suggestion by making the regulations effective 30 days after the date the final regulations are published in the **Federal Register**.

Although the final regulations do not provide for an election to apply the regulations retroactively, taxpayers who comply with the rules set forth in the regulations for leases entered into after August 5, 1997, and prior to the effective date of the regulations (other than the reporting requirement) will be treated as meeting the requirements of section 110.

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 any burden on taxpayers is minimal. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

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Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.110–1 also issued under 26 U.S.C. 110(d); * * *

Par. 2. Section 1.110–1 is added to read as follows:

§1.110–1 Qualified lessee construction allowances.

(a) *Overview*. Amounts provided to a lessee by a lessor for property to be constructed and used by the lessee pursuant to a lease are not includible in the lessee's gross income if the amount is a qualified lessee construction allowance under paragraph (b) of this section.

(b) *Qualified lessee construction allowance*—(1) *In general*. A qualified lessee construction allowance means any amount received in cash (or treated as a rent reduction) by a lessee from a lessor—

(i) Under a short-term lease of retail space;

(ii) For the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at that retail space; and

(iii) To the extent the amount is expended by the lessee in the taxable year received on the construction or improvement of qualified long-term real property for use in the lessee's trade or business at that retail space.

(2) *Definitions*—(i) *Qualified long-term real property* is nonresidential real property under section 168(e)(2)(B) that is part of, or otherwise present at, the retail space referred to in paragraph (b)(1)(i) of this section and which reverts to the lessor at the termination of the lease. Thus, qualified long-term real property does not include property qualifying as section 1245 property under section 1245(a)(3).

(ii) *Short-term lease* is a lease (or other agreement for occupancy or use) of retail space for 15 years or less (as determined pursuant to section 168(i)(3)).

(iii) *Retail space* is nonresidential real property under section 168(e)(2)(B) that is leased, occupied, or otherwise used by the lessee in its trade or business of selling tangible personal property or services to the general public. The term *retail space* includes not only the space where the retail sales are made, but also space where activities supporting the retail activity are performed (such as an administrative office, a storage area, and employee lounge). Examples of services typically sold to the general public include services provided by hair stylists, tailors, shoe repairmen, doctors, lawyers, accountants, insurance agents, stock brokers, securities dealers (including dealers who sell securities out of inventory), financial advisors and bankers. For purposes of this paragraph (b)(2)(iii), a taxpayer is selling to the general public if the products or services for sale are made available to the general public, even if the product or service is targeted to certain customers or clients.

(3) *Purpose requirement*. An amount will meet the requirement in paragraph (b)(1)(ii) of this section only to the extent that the lease agreement for the retail space expressly provides that the construction allowance is for the purpose of constructing or improving qualified long-term real property for use in the lessee's trade or business at the retail space. An ancillary agreement between the lessor and the lessee providing for a construction allowance, executed contemporaneously with the lease or during the term of the lease, is considered a provision of the lease agreement for purposes of the preceding sentence, provided the agreement is executed before payment of the construction allowance.

(4) *Expenditure requirement*—(i) *In general*. Expenditures referred to in paragraph (b)(1)(iii) of this section may be treated as being made first from the lessee's construction allowance. Tracing of the construction allowance to the actual lessee expenditures for the construction or improvement of qualified long-term real property is not required. However, the lessee should maintain accurate records of the amount of the qualified lessee construction allowance received and the expenditures made for qualified long-term real property.

(ii) *Time when expenditures deemed made*. For purposes of paragraph (b)(1)(iii) of this section, an amount is deemed to have been expended by a lessee in the taxable year in which the construction allowance was received by the lessee if—

(A) The amount is expended by the lessee within 8 1/2 months after the close of the taxable year in which the amount was received; or

(B) The amount is a reimbursement from the lessor for amounts expended by the lessee in a prior year and for which the lessee has not claimed any depreciation deductions.

(5) *Consistent treatment by lessor*. Qualified long-term real property constructed or improved with any amount excluded from a lessee's gross income by reason of paragraph (a) of this section must be treated as nonresidential real property owned by the lessor (for purposes of depreciation under 168(e)(2)(B) and determining gain or loss under section 168(i)(8)(B)). For purposes of the preceding sentence, the lessor must treat the construction allowance as fully expended in the manner required by paragraph (b)(1)(iii) of this section unless the lessor is notified by the lessee in writing to the contrary. General tax principles apply for purposes of determining when the lessor may begin depreciation of its nonresidential real property. The lessee's exclusion from gross income under paragraph (a) of this section, however, is not dependent upon the lessor's treatment of the property as nonresidential real property.

(c) *Information required to be furnished*—(1) *In general*. The lessor and the lessee described in paragraph (b) of this section who are paying and receiving a qualified lessee construction allowance, respectively, must furnish the information described in paragraph (c)(3) of this section in the time and manner prescribed in paragraph (c)(2) of this section.

(2) *Time and manner for furnishing information*. The requirement to furnish information under paragraph (c)(1) of this section is met by attaching a statement with the information described in paragraph (c)(3) of this section to the lessor's or the lessee's, as applicable, timely filed (including extensions) Federal income tax return for the taxable year in which the construction allowance was paid by the lessor or received by the lessee (either in cash or treated as a rent reduction), as applicable. A lessor or a lessee may report the required information for several qualified lessee construction allowances on a combined statement. However, a lessor's or a lessee's failure to provide information with respect to each lease will be treated as a separate failure to provide information for purposes of paragraph (c)(4) of this section.

(3) *Information required*—(i) *Lessor*. The statement provided by the lessor must contain the lessor's name (and, in the case of a consolidated group, the parent's name), employer identification number, taxable year and the following information for each lease:

(A) The lessee's name (in the case of a consolidated group, the parent's name).

(B) The address of the lessee.

(C) The employer identification number of the lessee.

(D) The location of the retail space (including mall or strip center name, if applicable, and store name).

(E) The amount of the construction allowance.

(F) The amount of the construction allowance treated by the lessor as nonresidential real property owned by the lessor.

(ii) *Lessee*. The statement provided by the lessee must contain the lessee's name (and, in the case of a consolidated group, the parent's name), employer identification number, taxable year and the following information for each lease:

(A) The lessor's name (in the case of a consolidated group, the parent's name).

(B) The address of the lessor.

(C) The employer identification number of the lessor.

(D) The location of the retail space (including mall or strip center name, if applicable, and store name).

(E) The amount of the construction allowance.

(F) The amount of the construction allowance that is a qualified lessee construction allowance under paragraph (b) of this section.

(4) *Failure to furnish information*. A lessor or a lessee that fails to furnish the information required in this paragraph (c)

may be subject to a penalty under section 6721.

(d) *Effective date*. This section is applicable to leases entered into on or after October 5, 2000.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (b) is amended by adding an entry for 1.110–1 to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 29, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 1, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 5, 2000, 65 F.R. 53584)

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.110–1	1545-1661
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Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368–1: Purpose and scope of exception of reorganization exchanges.

T.D. 8898

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

Continuity of Interest

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance regarding the continuity of interest requirement for corporate reorganizations. The final regulations affect corporations and their shareholders. The final regulations provide that distributions and redemptions by a target corporation prior to a potential reorganization are taken into account for continuity of interest purposes to the extent that the consideration received by the target shareholder in the redemption or distribution is treated as other property or money under section 356 of the Internal Revenue Code, or to the extent that the consideration would be treated as other property or money if the target shareholder also had received stock of the issuing corporation in exchange for stock owned by the shareholder in the target corporation.

DATES: *Effective Dates*: These regulations are effective August 30, 2000.

Applicability Dates: For dates of applicability of these regulations, see the "Effective Dates" portion of the Supplementary Information of the preamble.

FOR FURTHER INFORMATION CONTACT: Marie Byrne, (202) 622-7750 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under 44 U.S.C. 3507 and assigned control number 1545-1691.

The collection of information in these regulations is in §1.368–1(e)(7). The information is a private letter ruling request to apply the final regulations to a transaction in which a taxpayer has entered into a binding agreement on or after January 28, 1998 (the effective date of §1.368–1T), and before the effective date of the final regulations. This information will be used to ensure that all parties to the transaction take consistent positions for Federal tax purposes. The collection of information is elective. If §1.368–1T would apply to a transaction, but the taxpayer would prefer to apply the final regulations, the taxpayer may elect to submit the information. The likely respondents are businesses or other for-profit institutions.

Comments concerning the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of 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. Any such comments should be submitted not later than October 30, 2000.

Comments are specifically requested concerning:

(a) Whether the collection of information is necessary for the proper performance of the functioning of the Internal Revenue Service, including whether the information will have practical utility;

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

(c) How the quality, utility, and clarity of the information requested may be enhanced;

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

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

Estimated total annual reporting burden: 1,500 hours

The annual burden per respondent varies from 50 to 200 hours, depending on individual circumstances, with an estimated average of 150 hours.

Estimated number of respondents: 10

Estimated frequency of responses: Once

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

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

On January 28, 1998, the Treasury Department and IRS published final regulations on the continuity of interest (COI) requirement for potential corporate reorganizations, which permitted former target corporation (T) shareholders to sell stock in the issuing corporation (P) without causing the potential reorganization to fail to satisfy the COI requirement (T.D. 8760, 1998–1 C.B. 803 [63 F.R. 4174]). Additionally, the IRS and Treasury Department published temporary (T.D. 8761, 1998–1 C.B. 812) and proposed regulations (REG–120882–97, 1998–1 C.B. 824) (the Temporary Regulations) in the **Federal Register** at 63 F.R. 4183 and 63 F.R. 4204, respectively, relating to redemptions of, and extraordinary distributions on, T stock prior to certain otherwise qualifying reorganizations.

The Treasury Department and IRS received written comments in response to the proposed regulations. A public hearing on the proposed regulations was held on May 26, 1998. After consideration of all comments, §1.368–1T, published at 63 F.R. 4183, is removed. Section 1.368–1(e) is amended by this Treasury decision.

Explanation of Provisions

The Internal Revenue Code provides general nonrecognition treatment for reorganization transactions specifically described in section 368. In addition to complying with the statutory requirements and certain other requirements, a transaction generally must satisfy the COI requirement. The purpose of the COI requirement is to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. COI requires that in substance a substantial part of the value of the proprietary interests in T be preserved in the reorganization. These final regulations address the effect on COI of prereorganization redemptions and distributions.

The Temporary Regulations

The Temporary Regulations provide that a proprietary interest in T is not preserved if, prior to and in connection with a potential reorganization, it is redeemed, or to the extent that, prior to and in connection with a potential reorganization, an extraordinary distribution is made with respect to it.

Several commentators argued that the Temporary Regulations are overly broad. Some suggested that the scope of the COI requirement should closely parallel the law regarding the "solely for voting stock" requirement for reorganizations under §368(a)(1)(B) and (C), because both the solely for voting stock requirement and the COI requirement arose out of similar concerns, i.e., to prevent transactions that resemble sales from qualifying for nonrecognition treatment available to corporate reorganizations. These commentators maintain that, similar to the solely for voting stock rule, prereorganization redemptions and extraordinary distributions by T should not be taken into account for COI purposes unless P directly or indirectly furnishes the consideration for the redemption or distribution. A rule that goes beyond this, they argue, converts the COI requirement into an asset continuity test, and thus overlaps with the continuity of business enterprise requirement (COBE) and the "substantially all the assets" requirement for certain reorganizations.

In addition, one commentator maintained that the Temporary Regulations provide inconsistent results by treating extraordinary distributions taxed as dividends under section 301 as the equivalent of sales proceeds for purposes of COI.

Other commentators expressed concern that certain types of taxpayers, such as S corporations, are inappropriately adversely affected by the approach of the Temporary Regulations. The commentators noted that when an S corporation merges into a C corporation, it is common for the S corporation, in advance of the reorganization, to make distributions in the amount of its accumulated adjustments account (AAA). If large enough, such distributions may cause the potential reorganization to fail to qualify for tax-free treatment because the COI requirement is not satisfied under the Temporary Regulations. These commentators believe that this application of the COI rules in the Temporary Regulations to S corporation reorganizations is inconsistent with section 1371, which generally provides that subchapter C applies to an S corporation, except to the extent inconsistent with subchapter S, because the practice of making prereorganization AAA distributions makes it more difficult for S corporations than for C corporations to qualify for reorganization treatment. Similar concerns arise when a controlled foreign corporation (CFC) distributes income from its previously taxed income account with respect to its subpart F income (see section 959). Another commentator suggested that distributions made by a C corporation immediately prior to a merger with a Regulated Investment Company (RIC) or Real Estate Investment Trust (REIT) should not be treated as extraordinary distributions. Under §§1.852–12 (for RICs) and 1.857–11 (for REITs), a C corporation that merges into a RIC or REIT must distribute all non-RIC or non-REIT earnings and profits before the end of the RIC's or REIT's first taxable year. Consequently, a C corporation typically will distribute such earnings and profits prior to a merger with a RIC or REIT.

After considering these comments, the purpose of the COI requirement, and the other existing protections that prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations, the Treasury Department and IRS have concluded that the approach of the final regulations best reflects the purpose of the COI requirement. The regulations provide that a proprietary interest in T (other than one held by P) is not preserved to the extent that consideration received prior to a potential reorganization, either in a redemption of T stock or in a distribution with respect to T stock, is treated as other property or money received in the exchange for purposes of section 356 or would be so treated if the T shareholder also had received stock of P in exchange for stock owned by the shareholder in T. In determining whether consideration is treated as other property or money under section 356 received in an exchange for a proprietary interest in T, taxpayers should consider all facts, circumstances, and relevant legal authorities.

The regulations posit for COI purposes that each T shareholder receives some P stock in exchange for T stock. Section 356 generally does not apply to a T shareholder who does not receive any P stock in exchange for T stock in a reorganization. See Rev. Rul. 74–515 (1974–2 C.B. 118). Solely for purposes of determining whether the COI requirement is satisfied, however, the regulations deem each T shareholder to have received some P stock in exchange for T stock (without ascribing any value to that stock). The regulations thus use the same criterion for determining whether COI is satisfied, regardless of whether a T shareholder receives any P stock. These final regulations do not offer safe harbors or special rules for the transactions about which commentators expressed concern. Unlike the temporary regulations, however, the final regulations do not automatically take all prereorganization redemptions and extraordinary distributions in connection with the reorganization into account for COI purposes.

Stock Repurchase Programs

Example 8 of §1.368–1(e)(6) illustrates the effect on COI of a general stock repurchase program. In the example, P repurchases a small percentage of its stock after a reorganization, as part of a preexisting stock repurchase program. COI is satisfied because the redemption of a small percentage of P stock was not in connection with the merger. In response to comments received, the IRS and Treasury Department issued further guidance on the effect of a stock repurchase program on COI in Rev. Rul. 99–58 (1999–52 I.R.B. 701). Because *Example 8* suggests a more restrictive approach to COI than was intended in this context, *Example 8* is removed by this Treasury decision.

Effect on Other Authorities

These COI regulations apply solely for purposes of determining whether the COI requirement is satisfied. No inference should be drawn from any provision of this regulation as to whether other reorganization requirements are satisfied, or as to the characterization of a related transaction.

Effect on Other Documents

The following publications do not apply to the extent they are inconsistent with these regulations:

Rev. Proc. 77–37 (1977–2 C.B. 568).

Rev. Proc. 86–42 (1986–2 C.B. 722).

Effective Dates

These regulations apply to transactions occurring after August 30, 2000, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998 (the date that the temporary and proposed regulations were filed with the **Federal Register**), and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulations to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for U.S. tax purposes, with respect to the applicability of the final regulations to the transaction.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these final regulations. It is hereby certified that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that while the burden of making this collection of information may be significant when applicable, taxpayers will have to make this collection of information only if they are corporations or shareholders of corporations who are parties to a purported reorganization in which COI would not be preserved under the Temporary regulations. The IRS estimates that the number of taxpayers who will need to make this collection of information will be 10 or fewer. 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, these final regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

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

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

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

1. Revising paragraph (e)(1)(ii).
2. Removing paragraph (e)(2)(ii).
3. Removing the paragraph designation (e)(2)(i).
4. Removing *Example 8* of paragraph (e)(6).
5. Redesignating *Example 9* of paragraph (e)(6) as *Example 8*.
6. Adding new *Example 9* to paragraph (e)(6).
7. Adding three sentences to the end of paragraph (e)(7).

The additions and revision read as follows:

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

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

(ii) For purposes of paragraph (e)(1)(i) of this section, a proprietary interest in the target corporation (other than one held by the acquiring corporation) is not preserved to the extent that consideration received prior to a potential reorganization, either in a redemption of the target corporation stock or in a distribution with respect to the target corporation stock, is treated as other property or money received in the exchange for purposes of section 356, or would be so treated if the target shareholder also had received stock of the issuing corporation in exchange for stock owned by the shareholder in the target corporation.

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(6) ***

Example 9. Preacquisition redemption by target corporation. T has two shareholders, A and B. P expresses an interest in acquiring the stock of T. A does not wish to own P stock. T redeems A's shares in T in exchange for cash. No funds have been or will be provided by P for this purpose. P subsequently acquires all the outstanding stock of T from B solely in exchange for voting stock of P. The cash received by A in the prereorganization redemption is not treated as other property or money under section 356, and would not be so treated even if A had received some stock of P in exchange for his T stock. The prereorganization redemption by T does not affect continuity of interest, because B's proprietary interest in T is unaffected, and the value of the proprietary interest in T is preserved.

(7)*** Paragraph (e)(1)(ii) of this section, however, applies to transactions occurring after August 30, 2000, unless the transaction occurs pursuant to a written agreement that is (subject to customary conditions) binding on that date and at all times thereafter. Taxpayers who entered into a binding agreement on or after January 28, 1998, and before August 30, 2000, may request a private letter ruling permitting them to apply the final regulation to their transaction. A private letter ruling will not be issued unless the taxpayer establishes to the satisfaction of the IRS that there is not a significant risk of different parties to the transaction taking inconsistent positions, for Federal tax purposes, with respect to the applicability of the final regulations to the transaction.

§1.368–1T [Removed]

Par. 3. Section 1.368–1T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. Section §602.101, paragraph (b) is amended by adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

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(b) ***

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 23, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 30, 2000, 8:45 a.m., and published in the issue of the Federal Register for August 31, 2000, 65 F.R. 52909)

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.368–1	1545-1691
* * * * *	

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)–4: Section 411(d)(6) protected benefits.

T.D. 8900

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Special Rules Regarding Optional Forms of Benefit Under Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations that 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 permit certain transfers between defined contribution plans that were not permitted under prior final regulations. These regulations affect qualified retirement plan sponsors, administrators, and participants.

DATES: These regulations are effective September 6, 2000.

FOR FURTHER INFORMATION CONTACT: Linda S. F. Marshall, 202-622-6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains 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. Section 204(g)(2) of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93-406, (88 Stat. 829) provides a parallel rule to section 411(d)(6)(B) of the Code that applies under Title I of ERISA, and authorizes the Secretary of the Treasury to provide exceptions to this parallel ERISA requirement. Thus, Treasury regulations issued under section 411(d)(6)(B) of the Code apply as well for purposes of section 204(g)(2) of ERISA.

Final regulations regarding section 411(d)(6)(B) (the 1988 regulations) were published in the **Federal Register** on July 8, 1988. The 1988 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, these 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) of the 1988 regulations permits a plan-to-plan transfer 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 elective transfer rule of §1.411(d)–4, Q&A-3(b) of the 1988 regulations has applied only to situations in which a participant's benefits have become distributable, its applicability has been 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 issued Notice 98–29 (1998–1 C.B. 1163) to request public comment on several ways of providing regulatory relief from the requirements of section 411(d)(6)(B) for defined contribution plans in view of these considerations. Most of the public comments received in response to Notice 98–29 indicated 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. After considering the comments received in response to Notice 98–29, the IRS and Treasury issued proposed regulations (REG–109101–98, 2000–16 I.R.B. 903), which were published in the **Federal Register** (65 F.R. 16546) on March 29, 2000, to propose relief from the requirements of section 411(d)(6)(B) in a wide range of circumstances.

Seventeen written comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. Nearly all of the written comments expressed support for the provisions of the proposed regulation that would provide relief from the requirements of section 411(d)(6)(B) and requested clarifications or extensions of that relief in various ways. After consideration of all of the written comments, the IRS and the Treasury Department are adopting the proposed regulations as revised by this Treasury Decision for the reasons summarized below.

These final regulations under section 411(d)(6)(B) do 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, and those requirements are not affected by these final regulations. Similarly, these final regulations do 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*

In order to simplify plan administration, these final regulations adopt a modified version of the rule set forth in the proposed regulations that significantly expands the permitted changes that may be made to alternative forms of payment under a defined contribution plan. Under the rule in 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 payment form (such as, for example, an annuity distribution), each of which was otherwise identical to the eliminated or restricted optional form of benefit. In the preamble to the proposed regulations, the IRS and the Treasury Department requested comments on whether an extended payment form should be required to be preserved as part of such a plan amendment, or should be required to be preserved in particular circumstances.

In general, comments stated that the rule set forth in the proposed regulations would simplify plan administration. However, most commentators also indicated that requiring the retention of an extended payment form would perpetuate administrative burdens that would not be justified by any comparative advantage to plan participants. These commentators pointed out various administrative burdens associated with retaining an extended payment form, such as maintaining a system to administer the extended payment form for the few (if any) participants who choose that payment form, including descriptions of the extended payment form in participant materials, explaining the extended payment form in response to participant inquiries, dealing with participant requests to accelerate distributions under the extended payment form, complying with the minimum required distribution rules of section 401(a)(9), and handling the problems that result from an increased incidence of missing participants. These commentators also pointed out the special burdens that maintenance of an extended payment option imposes in mergers and acquisitions. These commentators took the position that, in light of a participant's ability to roll over distributions to one or more IRAs, which commonly offer a far wider array of alternative payment forms, and in light of the ability of many participants to choose to retain their full vested account balance in the qualified plan, there is little or no advantage to the participant in rules requiring the plan sponsor to retain an option to receive extended payments from a qualified defined contribution plan.

After considering these comments regarding the desirability of requiring the retention of an extended payment form, and in light of the ability of participants to replicate any extended payment form that a defined contribution plan may offer by rolling over a single-sum distribution to an IRA, the IRS and the Treasury Department have determined that any advantages of requiring the retention of an extended payment form are outweighed by the countervailing considerations. Accordingly, these final regulations generally provide that 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 a single-sum distribution form that is otherwise identical to the optional form of benefit that is being eliminated or restricted. The final regulations adopt the rules set forth in the proposed regulations for determining whether a single-sum distribution is otherwise identical to an optional form of benefit that is being eliminated or restricted.

However, the final regulations include a provision that protects participants taking distributions shortly after the plan is amended, who may have planned on the availability of the payment form that is being eliminated or restricted. Under this provision, a plan amendment that eliminates or restricts the ability of a participant to receive a particular optional form of benefit cannot apply to any distribution that has an annuity starting date earlier than the 90th day[1] after the date the participant receiving the distribution has been furnished a summary that reflects the amendment and that satisfies the requirements of the Labor Department regulations at 29 CFR 2520.104b–3 relating to a summary of material modifications for pension plans (or, if earlier, the first day of the second plan year following the plan year in which the amendment is adopted).

As noted above, the final regulations do not affect the survivor annuity requirements of sections 401(a)(11) and 417 or the direct rollover requirements of section 401(a)(31).

One commentator expressed concern that permitting plan amendments that eliminate alternative forms of payment would have the effect of permitting the elimination of subsidized early retirement benefits (i.e., distribution forms available upon early retirement that have a higher actuarial value than the normal retirement benefit that has been accrued at the time the distribution begins). These regulations, however, permit plan amendments eliminating alternative forms of payment only in certain circumstances involving defined contribution plans. Under a defined contribution plan, a participant is entitled to a distribution, in whatever form may be provided under the plan, only to the extent of the participant's individual account, plus earnings thereon. Accordingly, no alternative form of payment can be subsidized relative to any other payment form available under a defined contribution plan. Thus, these regulations do not have the effect of permitting the elimination of any early retirement subsidy or any other subsidized benefit forms.

B. *Voluntary Direct Transfers Between Plans*

Under certain circumstances, the 1988 regulations permitted elimination of optional forms of benefit in connection with transfers of benefits from one plan to another with a participant's consent. See §1.411(d)–4, Q&A-3(b) (as contained in 26 CFR part 1 revised April 1, 2000). The proposed regulations contained a number of changes to the 1988 regulations that would significantly liberalize the application of these elective transfer provisions. These final regulations generally finalize the provisions of the proposed regulations relating to elective transfers, with certain modifications that are described below.

The 1988 regulations permitted an elective transfer from one qualified plan to another only if the participant's benefit under the transferring plan was immediately distributable (a distributable event transfer). This condition precluded use of the elective transfer provision in the 1988 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 were not distributable because section

[1] This 90-day requirement is parallel to the 90-day election period applicable to any plan that is subject to the joint and survivor annuity requirements of section 417.

401(k)(10) was not applicable. In response to Notice 98–29, many commentators 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 previously earned 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.

Section 1.411(d)–4, Q&A-3(c) of these final regulations retains and modifies the previously applicable section 411(d)(6) relief for distributable event transfers, and §1.411(d)–4, Q&A-3(b) of these final regulations adds new section 411(d)(6) relief for transfers in connection with certain corporate mergers and acquisitions or changes in the participant's employment status (transaction or employment change transfers). As a result, relief from section 411(d)(6) applies in each of the following cases:

- *Direct rollover*. Existing rules provide that if a direct rollover is made from one qualified retirement plan to another, as described in section 401(a)(31), the receiving plan is not required by section 411(d)(6) to offer the same optional forms of benefit as the sending plan offered. See §1.401(a)(31)–1, Q&A-14.
- *Distributable event transfer*. As discussed further below, in any case in which a participant is entitled to a distribution from either a defined benefit plan or a defined contribution plan but the participant is not eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that can be entirely rolled over, these final regulations provide section 411(d)(6) relief for a voluntary transfer. Thus, these regulations modify the distributable event transfer provisions of the 1988 regulations.
- *Transaction or employment change transfer*. As discussed further below, even if a participant is not entitled to a distribution to which the preceding rules would apply, these final regulations, like the proposed regulations, allow a voluntary transfer from a defined contribution plan to another defined contribution plan of the same type if the transfer occurs in connection with a corporate merger or acquisition or a change in the participant's employment status. See §1.411(d)–4, Q&A-3(b).

Under certain circumstances, it may be possible to accomplish a voluntary transfer of a participant's benefit from one defined contribution plan to another that could be structured as either a distributable event transfer or a transaction or employment change transfer. In such a situation, the plans would be required to comply with the requirements applicable to either one of those sets of rules with respect to the transfer.

1. *Expansion of Section 411(d)(6) Relief for Distributable Event Transfers*

Under section 401(a)(31), which was enacted after the issuance of the 1988 regulations, 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, including distributions that are directly rolled over to another plan under section 401(a)(31). Accordingly, for amounts that are distributable in an eligible rollover distribution, the elective transfer rules of the 1988 regulations have largely been duplicated by the enactment of section 401(a)(31) because the same section 411(d)(6) result generally is available through a direct rollover. These final regulations generally eliminate this duplication. Under these final regulations, for transfers occurring on or after January 1, 2002, the distributable event transfer rules are not available if the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C). (Instead, the plan must offer a section 401(a)(31) direct rollover.) However, in other situations, including situations in which a single-sum distribution is not available or the participant's benefit includes an amount attributable to after-tax employee contributions, the distributable event transfer rules will be available.

Some commentators requested that plans have the ability to characterize a transfer that could be accomplished totally or in part as a direct rollover under section 401(a)(31) as a direct transfer to which section 411(d)(6) relief applies. They point out that this procedure is permitted under the 1988 regulations and that this procedure would simplify plan administration. These final regulations clarify that plans are not required to bifurcate a transaction into a partial section 401(a)(31) direct rollover and a partial elective transfer to which section 411(d)(6) relief applies, but that plans are permitted, as an alternative to bifurcation, to treat such a transaction entirely as an elective transfer to which section 411(d)(6) relief applies. However, as noted above, for transfers occurring on or after January 1, 2002, this section 411(d)(6) relief for distributable event transfers does not apply to an elective transfer that occurs at a time at which the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable account balance in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C). Instead, a similar result could be achieved by means of a direct rollover to which section 401(a)(31) applies.

Under the proposed regulations, the section 411(d)(6) relief for transfers of immediately distributable amounts other than eligible rollover distributions would only have applied to transfers between plans of the same type (i.e., transfers from defined benefit plans to defined benefit plans and transfers from defined contribution plans to defined contribution plans), notwithstanding that the 1988 regulations granted section 411(d)(6) relief to transfers between plans of different types (i.e., transfers from defined benefit plans to defined contribution plans and vice versa). The preamble specifically requested comments on whether section 411(d)(6) relief was needed for distributable event transfers between different types of plans, given the availability of direct rollovers. Several commentators stated that this section 411(d)(6) relief provided under the 1988 regulations was still valuable and also requested clarification that the relief applied to transfers of amounts that were immediately distributable only in the form of periodic payments commencing immediately. These final regulations adopt both of these recommendations.

2. *Section 411(d)(6) Relief for Transaction or Employment Change Transfers*

Section 1.411(d)–4, Q&A-3(b) of these final regulations retains and, in some respects, expands provisions of the proposed regulations that grant, subject to certain conditions, broad section 411(d)(6) relief for many types of elective transfers of a participant's entire benefit under a defined contribution plan, whether or not the benefit is immediately distributable (and whether or not the participant would be eligible for a distribution of the participant's entire benefit in a single-sum distribution that would be an eligible rollover distribution). In order to ensure that the participant's election occurs in connection with an independent event (and is not, in effect, a mere waiver), the transfer must be made either in connection with certain corporate transactions (such as a merger or acquisition) or in connection with a participant's change in employment status (for example, the participant's transfer to a different subsidiary or division of the employer, without regard to whether the transfer constitutes a separation from service) to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan, even if the event is not one that triggers the right to an immediate distribution. Such elective transfers can be made to a plan that is outside the employer's controlled group, to another plan of the same employer, or to a plan that is maintained by another member of the employer's controlled group.

A transaction or employment change transfer may involve benefits that are not fully vested under the transferor plan. However, where a participant's benefit that is not fully vested under the transferor plan is transferred pursuant to these rules, the vesting schedule amendment requirements of section 411(a)(10) must be satisfied.

A transaction or employment change transfer generally is only permitted between defined contribution plans 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 transaction or employment change transfers are permitted facilitate administration of the qualified plan distribution rules by ensuring that amounts transferred to the receiving plan, in a transfer that is not itself a distribution, 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 of sections 401(a)(11)(A) and 417, those survivor annuity requirements would in any event apply to the receiving plan with respect to the transferred amount as a result of the transferee plan rule of section 401(a)(11)(B)(iii)(III).

In response to comments, the final regulations clarify that the right to a transaction or employment change transfer is an other right or feature for purposes of section 401(a)(4) (unlike a distributable event transfer, which is treated as an optional form of benefit for purposes of section 401(a)(4)). In applying section 401(a)(4) to a transaction or employment change transfer right, the final regulations permit certain conditions to be disregarded. Thus, for example, section 401(a)(4) would be satisfied if, with respect to all participants: (1) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of any asset or stock disposition, merger or other similar business transaction involving a change of the employer; (2) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of an identified asset or stock disposition, merger or other similar business transaction that involves a change of the employer; or (3) the plan provides a transfer right in the event that an employee ceases to be covered by the plan because of a transfer of employment to a position covered by another plan within the employer's controlled group.

C. *Rules Regarding In-Kind Distributions*

The final 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 from defined contribution plans and defined benefit plans. Provisions for distribution in kind are sometimes found, for example, 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 ERISA. The 1988 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.

The proposed regulations provided that, if a defined benefit plan included an optional form of benefit under which benefits were distributed in the medium of an annuity contract, that optional form of benefit could be modified by substituting cash for the annuity contract. The proposed regulations separately provided a similar rule for defined contribution plans that provided an annuity optional form of benefit and for distribution of an annuity contract, and that substituted a non-annuity optional form of benefit for the annuity form. These final regulations combine and simplify these two rules. The final regulations clarify that a participant's right to receive a particular benefit in the form of cash payments from either a defined benefit plan or a defined contribution plan and a participant's right to receive that benefit in the form of the distribution of an annuity contract that provides for cash payments that are otherwise identical in all respects to those cash payments from the plan are not separate optional forms of benefit. Therefore, for example, if a plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract that provides for cash payments, that optional form of benefit may be modified by a plan amendment that substitutes cash payments from the plan for the distribution of the annuity contract, where those cash payments from the plan are identical to the cash payments payable from the annuity contract in all respects except for the source of the payments. Of course, a defined contribution plan that continues to offer a life annuity form of distribution must purchase an annuity contract from an insurance carrier in order to provide that optional form (and the plan may either distribute that contract to the participant or hold the contract as a plan asset from which it makes the payments for the participant).

These final regulations 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. Thus, the right to distributions from a defined contribution plan in the form of cash, employer securities or other property that is not marketable securities is generally protected. The protection for employer securities reflects the potential value of the special tax treatment provided to net unrealized appreciation (NUA) on employer securities under section 402(e)(4). The protection for assets that are not marketable securities reflects that possibility that a participant may assign a higher value to such assets than the plan without the participant having the ability to acquire the asset after receiving a cash distribution.

The proposed regulations would 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 can be made to a participant to specific types of property allocated to the participant's account 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 allocated to the participant's account at the time of the distribution include that type of property.

These provisions of the proposed regulations were supported by commentators and have been adopted in these final regulations. In response to commentator suggestions, the examples from the proposed regulations have been modified in these regulations to clarify that a plan amendment that limits the right of a distribution in specified types of property to certain participants, as permitted by these regulations, need not itself contain a list of those participants. These provisions of the final regulations do not permit a plan to be amended in a way that affects protected features of optional forms of benefit other than the medium of distribution.

Effective Date and Applicability Date

These final regulations are effective September 6, 2000. These final regulations apply to plan amendments that are adopted and effective on or after September 6, 2000, except as provided in §1.411(d)–4, Q&A-2(e)(1)(ii) and Q&A-3(c)(1)(ii).

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, 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, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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. In paragraph (a)(1), removing the language "in paragraph (b) of this Q&A-2" and adding the language "in this section" in its place.

b. Adding two sentences at the beginning of paragraph (a)(3)(ii)(A).

c. Revising the second sentence of paragraph (b)(2) introductory text.

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

e. Amending paragraph (b)(2)(viii) by removing the language " of the employer".

f. 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).

The additions and revisions read as follows:

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

* * * * *

A-2: * * *

(a) * * *

(3) * * *

(ii) *Annuity contracts*—(A) *General rule*. The right of a participant to receive a benefit in the form of cash payments from the plan and the right of a participant to receive that benefit in the form of the distribution of an annuity contract that provides for cash payments that are identical in all respects to the cash payments from the plan except with respect to the source of the payments are not separate optional forms of benefit. Therefore, for example, if a plan includes an optional form of benefit under which benefits are distributed in the medium of an annuity contract that provides for cash payments, that optional form of benefit may be modified by a plan amendment that substitutes cash payments from the plan for the annuity contract, where those cash payments from the plan are identical to the cash payments payable from the annuity contract in all respects except with respect to the source of the payments. * * *

* * * * *

(b) * * *

(2) * * * The rules with respect to permissible eliminations and reductions provided in this paragraph (b)(2) generally are effective January 30, 1986; however, the rules of paragraphs (b)(2)(iii)(A) and

(B) and (b)(2)(viii) of this Q&A-2 are effective for plan amendments that are adopted and effective on or after September 6, 2000. * * *

* * * * *

(iii) *In-kind distributions*—(A) *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 a plan amendment that substitutes cash for the marketable securities as the medium of distribution. For purposes of this paragraph (b)(2)(iii)(A) and paragraph (b)(2)(iii)(B) of this Q&A-2, 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).

(B) *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 marketable securities that are not securities of the employer) that are allocated to 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 if a distributable event occurred. 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 allocated to the participant's account at the time of distribution that consists of property of those specified types.

(C) *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 as the medium of distribution 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.

(D) *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 October 18, 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 (and participants' accounts have ceased to be invested in employer securities), to eliminate the right to a distribution in the form of employer stock. See paragraph (b)(2)(iii)(B) 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)(A) 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 provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii)(A) and (B) 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 those assets are allocated to the participant's account at the time of the distribution. See paragraphs (b)(2)(iii)(A) and (B) 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 provides that only participants with employer stock allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of employer stock, and that only participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment have the right to distributions in the form of shares of PQR limited partnership, and that further provides that the distribution of that stock or those shares is available only to the extent that those assets are allocated to those participants' accounts at the time of the distribution. To comply with the plan amendment, the plan administrator retains a list of participants with employer stock allocated to their accounts as of the effective date of the amendment, and a list of participants with shares of PQR limited partnership allocated to their accounts as of the effective date of the amendment. See paragraphs (b)(2)(iii)(A) and (B) 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)(C) 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—

(i) After the plan amendment is effective with respect to the participant, the alternative forms of payment available to the participant include payment in a single-sum distribution form that is otherwise identical to the optional form of benefit that is being eliminated or restricted; and

(ii) The amendment does not apply to the participant with respect to any distribution with an annuity starting date that is earlier than the earlier of—

(A) The 90th day after the date the participant has been furnished a summary that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3 (relating to a summary of material modifications) for pension plans; or

(B) The first day of the second plan year following the plan year in which the amendment is adopted.

(2) *Otherwise identical single-sum distribution*. For purposes of this paragraph (e), a single-sum distribution form is otherwise identical to an optional form of benefit that is eliminated or restricted pursuant to paragraph (e)(1) of this Q&A-2 only if the single-sum 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 otherwise identical 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, or imposes any condition of eligibility that did not apply to the installment form. However, 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 would not be protected from elimination or restriction under section 411(d)(6) or this section.

(3) *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 with a calendar plan year 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). On May 15, 2001, 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, subject to the requirements of section 401(a)(9)). The amendment does not apply to P if P elects to have annuity payments begin before the earlier of January 1, 2003, or 90 days after the date on which the plan administrator of Plan M furnishes P with a summary that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3. On December 14, 2001, the plan administrator of Plan M furnishes P with a summary plan description that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3.

(ii) Plan M does not violate the requirements of section 411(d)(6) (or section 401(a)(11)) merely because, as of March 14, 2002, 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. On May 15, 2001, 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, 15, or 20 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, subject to the requirements of section 401(a)(9)), in the form of a single-sum distribution. The amendment does not apply to P if P elects to have annuity payments begin before January 1, 2002. On September 20, 2001, the plan administrator of Plan M furnishes P with a summary of material modifications that reflects the amendment and that satisfies the requirements of 29 CFR 2520.104b–3.

(ii) Plan M does not violate the requirements of section 411(d)(6) merely because, as of January 1, 2002, the plan amendment has eliminated P's option to receive a distribution in the form of substantially equal monthly installment payments over 5, 10, 15, or 20 years.

(4) *Effective date*. This paragraph (e) applies to plan amendments that are adopted on or after September 6, 2000.

* * * * *

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 any direct rollover described in Q&A-3 of §1.401(a)(31)–1) 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 either 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 change in employment status to an employment status with respect to which the participant is not entitled to 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) and, thus, must satisfy the requirements of section 414(l). In addition, this paragraph (b) only provides relief under section 411(d)(6); a transfer described in this paragraph must satisfy 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 411(a)(10) with respect to the amounts transferred.

(3) *Status of elective transfer as other right or feature*. A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (b) is an other right or feature within the meaning of §1.401(a)(4)–4(e)(3), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4. However, for purposes of applying the rules of §1.401(a)(4)–4, the following conditions are to be disregarded in determining the employees to whom the other right or feature is available—

(i) A condition restricting the availability of the transfer to benefits of participants who are transferred to a different employer in connection with a specified asset or stock disposition, merger, or other similar transaction involving a change in employer of the employees of a trade or business (i.e., a disposition within the meaning of §1.410(b)–2(f)), or in connection with any such disposition, merger, or other similar transaction.

(ii) A condition restricting the availability of the transfer to benefits of participants who have a change in employment status to an employment status with respect to which the participant is not entitled to additional allocations under the transferor plan.

(c) *Elective transfers of certain distributable benefits between qualified plans*—(1) *In general*. A transfer of a participant's benefits between qualified plans that results in the elimination or reduction of section 411(d)(6) protected benefits does not violate section 411(d)(6) if—

(i) The transfer occurs at a time at which the participant's benefits are distributable (within the meaning of paragraph (c)(3) of this Q&A-3);

(ii) For a transfer that occurs on or after January 1, 2002, the transfer occurs at a time at which the participant is not eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of section 401(a)(31)(C);

(iii) The voluntary election requirements of paragraph (b)(1)(i) of this Q&A-3 are met;

(iv) The participant is fully vested in the transferred benefit in the transferee plan;

(v) In the case of a transfer from a defined contribution plan to a defined benefit plan, the defined benefit plan provides a minimum benefit, for each participant whose benefits are transferred, equal to the benefit, expressed as an annuity payable at normal retirement age, that is derived solely on the basis of the amount transferred with respect to such participant; and

(vi) The amount of the benefit transferred, together with the amount of any contemporaneous section 401(a)(31) direct rollover to the transferee plan, equals the entire nonforfeitable accrued benefit under the transferor 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*—(i) *In general*. A 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. A transfer pursuant to the elective transfer rules of this paragraph (c) is not treated as a distribution for purposes of the minimum distribution requirements of section 401(a)(9).

(ii) *Status of elective transfer as optional form of benefit*. A right to a transfer of benefits from a plan pursuant to the elective transfer rules of this paragraph (c) is an optional form of benefit under section 411(d)(6), the availability of which is subject to the nondiscrimination requirements of section 401(a)(4) and §1.401(a)(4)–4.

(3) *Distributable benefits*. For purposes of paragraph (c)(1)(i) of this Q&A-3, 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 (e.g., in the form of an immediately commencing annuity) from that plan under provisions of the plan not inconsistent with section 401(a).

(d) *Effective date*. *This Q&A-3* is applicable for transfers made on or after September 6, 2000.

* * * * *

Robert E. Wenzel,
Deputy Commissioner
of Internal Revenue.

Approved August 28, 2000.

Jonathan Talisman,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 31, 2000, 2:25 p.m., and published in the issue of the Federal Register for September 6, 2000, 65 F.R. 53901)

Section 2702.—Special Valuation Rules in Case of Transfers of Interests in Trusts

26 CFR 25.2702–3: Qualified interests.

T.D. 8899

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 25

Definition of a Qualified Interest in a Grantor Retained Annuity Trust and a Grantor Retained Unitrust

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the definition of a qualified interest under section 2702 of the Internal Revenue Code. The final regulations apply to a grantor retained annuity trust (GRAT) and a grantor retained unitrust (GRUT) in determining whether a retained interest is a qualified interest. These final regulations affect individuals who make a transfer in trust to a family member and retain an interest in the trust. These final regulations clarify that a trust that uses a note, other debt instrument, option, or similar financial arrangement to satisfy the annual payment obligation does not meet the requirements of section 2702(b).

DATES: *Effective Date*: These regulations are effective September 5, 2000.

FOR FURTHER INFORMATION CONTACT: James F. Hogan, (202)622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On June 22, 1999, the IRS published in the **Federal Register** (64 F.R. 33235) a notice of proposed rulemaking (REG–108287–98, 1999–28 I.R.B. 27) relating to the definition of a *qualified interest* under section 2702. The IRS received comments on the notice of proposed rulemaking; however, no request for a public hearing was received so no public hearing was held. This document adopts final regulations with respect to the notice of proposed rulemaking. A summary of the principal comments received is provided below.

In addition, the final regulations clarify the regulatory rule regarding the payment period of the annuity or unitrust amount and the proration of payments for periods of less than 12 months.

Comments on Notice of Proposed Rulemaking

Under the proposed regulations, the use of a note, other debt instrument, option, or similar financial arrangement does not constitute a payment of the annuity or unitrust amount to the grantor as required by section 2702. Further, the proposed regulations provide that a retained interest is not a qualified interest under section 2702, unless the trust instrument expressly prohibits the use of notes, other debt instruments, options, or similar financial arrangements.

Commentators suggested that the regulations should permit the use of short-term notes or notes that bear interest at the section 7520 rate. This suggestion was not adopted. A note issued by the trust, regardless of the term or the interest rate, effectively defers the required payment. Thus, the issuance of a note is not the current payment of the annuity or unitrust amount not less frequently than annually as required by the statute. Under these provisions, in order to satisfy the annuity or unitrust payment obligation under section 2702(b), the annuity or unitrust amount must be paid with either cash or other assets held by the trust.

Commentators also questioned whether the prohibition on the use of notes to make the annuity or unitrust payment applies if the trustee borrows the required funds from an unrelated party. The Treasury Department and the IRS acknowledge that a trustee may borrow from an unrelated party to make the payment. However, the step transaction doctrine will be applied where a series of transactions is used to achieve a result that is inconsistent with the regulations. For example, suppose that the trustee borrows cash from a bank to make the required annuity payment and then borrows cash from the grantor to repay the bank. Similarly, suppose the grantor requests that a bank make a loan to the trust, but as a prerequisite for making the loan, the bank requires the grantor to deposit with the bank an amount equal to the loan. There is no substantive difference between these series of transactions and the situation in which a trustee issues a note for the annuity amount directly to the grantor. The final regulations have added the words "directly or indirectly" to clarify this point.

In response to a comment, the final regulations clarify that a trust instrument provision expressly prohibiting the use of notes to satisfy the annual payments is not required for trusts established before September 20, 1999. However, as provided in the regulations, a retained interest in a trust established before September 20, 1999, will not be treated as a qualified interest if notes are used after September 20, 1999, to satisfy the payment obligation, or any notes issued to satisfy the annual payment obligation on or prior to September 20, 1999, are not paid in full by December 31, 1999.

Proration of First Year's Payment

In response to comments, the regulations clarify the rules covering the period on which the annual payment must be based and the proration of the annuity or unitrust amount in the case of short periods. The final regulations make it clear that the annuity or unitrust amount need not be payable based on the taxable year of the trust. Rather, the annuity or unitrust amount may be payable annually or more frequently, (for example, monthly, quarterly, or semi-annually) based on the anniversary date of the creation of the trust. Thus, a trust providing for an annuity interest created on May 1st need not require that the trustee make payments based on the taxable year of the trust. Instead, the entire annual payment may be made by April 30th of each succeeding year of the trust term. If payment is based on the anniversary date of the trust, proration of the annuity or unitrust amount will be required only if the last period during which such amount is payable to the grantor is a short period. On the other hand, if payment is based on the taxable year of the trust, proration is required for each short taxable year of the trust during the grantor's term.

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) and the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply to these regulations, and therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is James F. Hogan, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 25 is amended as follows:

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 1. The authority citation for part 25 continues to read in part as follows:

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

Par. 2. Section 25.2702–3 is amended as follows:

1. Paragraph (b)(1)(i) is amended by revising the second and fourth sentences, and removing the last sentence.

2. Paragraph (b)(3) is revised.

3. Paragraph (b)(4) is redesignated as paragraph (b)(5).

4. A new paragraph (b)(4) is added.

5. Paragraph (c)(1)(i) is amended by revising the third and fifth sentences and removing the last sentence.

6. Paragraph (c)(3) is revised.

7. Paragraphs (c)(4) and (d)(5) are added.

The revisions and additions read as follows:

§25.2702–3 Qualified interests.

* * * * *

(b) * * *

(1) * * * (i) * * * The annuity amount must be payable to (or for the benefit of) the holder of the annuity interest at least annually. * * * Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the annuity amount does not constitute payment of the annuity amount.

* * * * *

(3) *Payment of annuity amount*. The annuity amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the annuity amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the annuity amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made based on the taxable year, proration of the annuity amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual annuity amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the annuity amount in certain circumstances*. An annuity amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date. An annuity amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to §1.671–4(b) of this chapter, the annuity payment must be made no later than the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to §1.671–4(a) of this chapter.

* * * * *

(c) * * *

(1) * * * (i) * * * The unitrust amount must be payable to (or for the benefit of) the holder of the unitrust interest at least annually. * * * Issuance of a note, other debt instrument, option, or other similar financial arrangement, directly or indirectly, in satisfaction of the unitrust amount does not constitute payment of the unitrust amount.

* * * * *

(3) *Payment of unitrust amount*. The unitrust amount may be payable based on either the anniversary date of the creation of the trust or the taxable year of the trust. In either situation, the unitrust amount may be paid annually or more frequently, such as semi-annually, quarterly, or monthly. If the payment is made based on the anniversary date, proration of the unitrust amount is required only if the last period during which the annuity is payable to the grantor is a period of less than 12 months. If the payment is made

based on the taxable year, proration of the unitrust amount is required for each short taxable year of the trust during the grantor's term. The prorated amount is the annual unitrust amount multiplied by a fraction, the numerator of which is the number of days in the short period and the denominator of which is 365 (366 if February 29 is a day included in the numerator).

(4) *Payment of the unitrust amount in certain circumstances*. A unitrust amount payable based on the anniversary date of the creation of the trust must be paid by the anniversary date. A unitrust amount payable based on the taxable year of the trust may be paid after the close of the taxable year, provided the payment is made no later than the date by which the trustee is required to file the Federal income tax return of the trust for the taxable year (without regard to extensions). If the trustee reports for the taxable year pursuant to §1.671–4(b) of this chapter, the unitrust payment must be made no later than the date by which the trustee would have been required to file the Federal income tax return of the trust for the taxable year (without regard to extensions) had the trustee reported pursuant to §1.671–4(a) of this chapter.

(d) * * *

(5) *Use of debt obligations to satisfy the annuity or unitrust payment obligation*—(i) *In general*. In the case of a trust created on or after September 20, 1999, the trust instrument must prohibit the trustee from issuing a note, other debt instrument, option, or other similar financial arrangement in satisfaction of the annuity or unitrust payment obligation.

(ii) *Special rule in the case of a trust created prior to September 20, 1999.* In the case of a trust created prior to September 20, 1999, the interest will be treated as a qualified interest under section 2702(b) if—

(A) Notes, other debt instruments, options, or similar financial arrangements are not issued after September 20, 1999, to satisfy the annuity or unitrust payment obligation; and

(B) Any notes or any other debt instruments that were issued to satisfy the annual payment obligation on or prior to September 20, 1999, are paid in full by December 31, 1999, and any option or similar financial arrangement issued to satisfy the annual payment obligation is terminated by December 31, 1999, such that the grantor receives cash or other trust assets in satisfaction of the payment obligation. For purposes of the preceding sentence, an option will be considered terminated only if the grantor receives cash or other trust assets equal in value to the greater of the required annuity or unitrust payment plus interest computed under section 7520 of the Internal Revenue Code, or the fair market value of the option.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved August 10, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 1, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 5, 2000, 65 F.R. 53587)

Part III. Administrative, Procedural, and Miscellaneous

2000 Marginal Production Rates

Notice 2000–50

Section 613A(c)(6)(C) of the Internal Revenue Code defines the term "applicable percentage" for purposes of determining percentage depletion for oil and gas produced from marginal properties. The applicable percentage is the percentage (not greater than 25 percent) equal to the sum of 15 percent, plus one percentage point for each whole dollar by which $20 exceeds the reference price (determined under § 29(d)(2)(C)) for crude oil for the calendar year preceding the calendar year in which the taxable year begins. The reference price determined under § 29(d)(2)(C) for the 1999 calendar year is $15.56.

Table 1 contains the applicable percentages for marginal production for taxable years beginning in calendar years 1991 through 2000.

Notice 2000–50 Table 1

APPLICABLE PERCENTAGE FOR MARGINAL PRODUCTION

Calendar Year	*Applicable Percentage*
1991	15 percent
1992	18 percent
1993	19 percent
1994	20 percent
1995	21 percent
1996	20 percent
1997	16 percent
1998	17 percent
1999	24 percent
2000	19 percent

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

2000 Section 43 Inflation Adjustment

Notice 2000–51

Section 43(b)(3)(B) of the Internal Revenue Code requires the Secretary to publish an inflation adjustment factor. The enhanced oil recovery credit under § 43 for any taxable year is reduced if the "reference price," determined under § 29(d)(2)(C), for the calendar year preceding the calendar year in which the taxable year begins is greater than $28 multiplied by the inflation adjustment factor for that year.

The term "inflation adjustment factor" means, with respect to any calendar year, a fraction the numerator of which is the GNP implicit price deflator for the preceding calendar year and the denominator of which is the GNP implicit price deflator for 1990.

Because the reference price for the 1999 calendar year ($15.56) does not exceed $28 multiplied by the inflation adjustment factor for the 2000 calendar year, the enhanced oil recovery credit for qualified costs paid or incurred in 2000 is determined without regard to the phase-out for crude oil price increases.

Table 1 contains the GNP implicit price deflator used for the 2000 calendar year, as well as the previously published GNP implicit price deflators used for the 1991 through 1999 calendar years.

Notice 2000–51 Table 1

GNP IMPLICIT PRICE DEFLATORS

Calendar Year	*GNP Implicit Price Deflator*
1990	112.9 (used for 1991)
1991	117.0 (used for 1992)
1992	120.9 (used for 1993)
1993	124.1 (used for 1994)
1994	126.0 (used for 1995)
1995	107.5 (used for 1996)*
1996	109.7 (used for 1997)
1997	112.35 (used for 1998)**
1998	112.64 (used for 1999)
1999	104.59 (used for 2000)***

* Beginning in 1995, the GNP implicit price deflator was rebased relative to 1992. The 1990 GNP implicit price deflator used to compute the 1996 § 43 inflation adjustment factor is 93.6.

** Beginning in 1997, two digits follow the decimal point in the GNP implicit price defltor. The 1990 GNP price deflator used to compute the 1998 § 43 inflation adjustment factor is 93.63.

*** Beginning in 1999, the GNP implicit price deflator was rebased relative to 1996. The 1990 GNP implicit price deflator used to compute the 2000 § 43 inflation adjustment factor is 86.53.

Table 2 contains the inflation adjustment factor and the phase-out amount for taxable years beginning in the 2000 calendar year as well as the previously published inflation adjustment factors and phase-out amounts for the 1991 through 1999 calendar years.

Notice 2000–51 Table 2

INFLATION ADJUSTMENT FACTORS AND PHASE-OUT AMOUNTS

Calendar Year	*Inflation Adjustment Factor*	*Phase-out Amount*
1991	1.0000	0
1992	1.0363	0
1993	1.0708	0
1994	1.0992	0
1995	1.1160	0
1996	1.1485	0
1997	1.1720	0
1998	1.1999	0
1999	1.2030	0
2000	1.2087	0

DRAFTING INFORMATION

The principal author of this notice is Brenda M. Stewart of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Ms. Stewart at (202) 622-3120 (not a toll-free call).

Renewable Electricity Production Credit, Publication of Inflation Adjustment Factor and Reference Prices for Calendar Year 2000

Notice 2000–52

This notice publishes the inflation adjustment factor and reference prices for calendar year 2000 for the renewable electricity production credit under § 45(a) of the Internal Revenue Code. The 2000 inflation adjustment factor and reference prices are used in determining the availability of the credit. The 2000 inflation adjustment factor and reference prices apply to calendar year 2000 sales of kilowatt-hours of electricity produced in the United States or a possession thereof from qualified energy resources.

BACKGROUND

Section 45(a) provides that the renewable electricity production credit for any tax year is an amount equal to the product of 1.5 cents multiplied by the kilowatt-hours of specified electricity produced by the taxpayer and sold to an unrelated person during the tax year. This electricity must be produced from qualified energy resources and at a qualified facility during the 10-year period beginning on the date the facility was originally placed in service.

Section 45(b)(1) provides that the amount of the credit determined under § 45(a) is reduced by an amount that bears the same ratio to the amount of the credit as (A) the amount by which the reference price for the calendar year in which the sale occurs exceeds 8 cents bears to (B) 3 cents. Under § 45(b)(2), the 1.5 cents in § 45(a) and the 8 cents in § 45(b)(1) are each adjusted by multiplying the amount by the inflation adjustment factor for the calendar year in which the sale occurs.

Section 45(c)(1) defines qualified energy resources as wind, closed-loop biomass, and poultry waste. Section 45(c)(3) defines a qualified facility as any facility owned by the taxpayer that originally is placed in service after December 31, 1993 (December 31, 1992, in the case of a facility using closed-loop biomass to produce electricity and December 31, 1999, in the case of a facility using poultry waste to produce electricity), and before January 1, 2002. See § 45(d)(7) for rules relating to the inapplicability of the credit to electricity sold to utilities under certain contracts.

Section 45(d)(2)(A) requires the Secretary to determine and publish in the Federal Register each calendar year the inflation adjustment factor and the reference prices for the calendar year. The inflation adjustment factor and the reference prices for the 2000 calendar year were published in the Federal Register on August 29, 2000, (168 Fed. Reg. 52474).

Section 45(d)(2)(B) defines the inflation adjustment factor for a calendar year as the fraction the numerator of which is the GDP implicit price deflator for the preceding calendar year and the denominator of which is the GDP implicit price deflator for the calendar year 1992. The term "GDP implicit price deflator" means the most recent revision of the implicit price deflator for the gross domestic product as computed and published by the Department of Commerce before March 15 of the calendar year.

Section 45(d)(2)(C) provides that the reference price is the Secretary's determination of the annual average contract price per kilowatt hour of electricity generated from the same qualified energy resource and sold in the previous year in the United States. Only contracts entered into after December 31, 1989, are taken into account.

INFLATION ADJUSTMENT FACTOR AND REFERENCE PRICES

The inflation adjustment factor for calendar year 2000 is 1.1382. The reference prices for calendar year 2000 are 4.95 cents per kilowatt-hour for facilities producing electricity from wind energy resources and 0 cents per kilowatt-hour for facilities producing electricity from closed-loop biomass and poultry waste energy resources.

PHASE-OUT CALCULATION

Because the 2000 reference prices for electricity produced from wind, closed-loop biomass, and poultry waste energy resources do not exceed 8 cents per kilowatt hour multiplied by the inflation adjustment factor, the phaseout of the credit provided in § 45(b)(1) does not apply to electricity produced from wind, closed-loop biomass, or poultry waste energy resources sold during calendar year 2000.

CREDIT AMOUNT

As required by § 45(b)(2), the 1.5¢ amount in § 45(a)(1) is adjusted by multiplying such amount by the inflation adjustment factor for the calendar year in which the sale occurs. If any amount as increased under the preceding sentence is not a multiple of 0.1¢, such amount is rounded to the nearest multiple of 0.1¢. Under the calculation required by § 45(b)(2), the renewable electricity production credit for calendar year 2000 is 1.7¢ per kilowatt hour on the sale of electricity produced from wind energy, closed-loop bionass, and poultry waste resources.

DRAFTING INFORMATION CONTACT

The principal author of this notice is David A. Selig of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice contact Mr. Selig at (202) 622-3040 (not a toll-free call).

SRLY Election

Notice 2000–53

This notice announces that the Treasury Department and the Internal Revenue Service intend to issue regulations permitting certain taxpayers to elect not to apply certain provisions of Treas. Reg. §§ 1.1502–15, – 21, and – 22 issued on June 25, 1999, and published in the Federal Register on July 2, 1999 (64 F.R. 36091). The notice also provides taxpayers a mechanism for making the election before the regulations are issued.

Treasury Regulations §§ 1.1502–15, –21, and –22 provide rules for computing the limitation with respect to separate return limitation year (SRLY) losses, and the carryover or carryback of losses to consolidated and separate return years. In §§ 1.1502–15(g), –21(g), and –22(g), the "overlap rule" eliminates the application of the SRLY rules in certain circumstances in which the rules of §§ 382 or 383 of the Internal Revenue Code also apply. The overlap rule, and consequently the elimination of the SRLY rules, is effective for tax years for which the due date of the return is after June 25, 1999. The elimination of SRLY could increase the amount of net operating loss carryovers that a consolidated group could absorb.

Treasury and the Service have been made aware that the application of the overlap rule has resulted in adverse tax consequences with respect to certain acquisitions of corporations from consolidated groups that occurred during a taxable year of the consolidated group to which the June 1999 regulations applied but prior to the actual issuance of those regulations (the "interim period"). Treasury and the Service believe that certain of these adverse tax consequences are inappropriate.

Accordingly, this notice announces that Treasury and the Service intend to issue regulations that provide an election to allow a corporation that ceased to be a member of a consolidated group as a result of a qualified stock purchase (as defined in § 338(d)(3)) in the interim period (the "departing member") to avoid the application of the overlap rule of §§ 1.1502–15(g), –21(g), and –22(g) while it was in the former group. The election will be available to a departing member of a consolidated group that would otherwise be affected by the application of the overlap rule and that ceased to be a member of the consolidated group before June 26, 1999, or pursuant to a binding contract that was in effect before June 26, 1999.

The election will allow a departing member to determine the amount of its net operating loss and capital loss carryovers (including the amount of net operating loss carryovers treated as arising under § 1.1502–15(a)) to taxable years beginning after it ceases to be a member of the group by treating §§ 1.1502–15(g), –21(g), and –22 (g) as not applying with respect to that corporation (or to a subgroup in which it was included) while it was a member of the group. The election will be made solely by the departing member (or, under § 1.1502–77, its new common parent if it joins another consolidated group). The election will not require any action by the departing member's former consolidated group and will have no effect on the consolidated return filed by that group for the taxable year for which the due date of the return was after June 25, 1999, or any subsequent taxable year.

To make the election under this notice, a corporation must write "Election Pursuant to Notice 2000–53" across the top of page 1 of its original or amended tax return for the first taxable year (whether separate or consolidated) after it ceases to be a member of the group and file the return in accordance with the election as if §§ 1.1502–15(g), –21(g), and –22(g) did not apply while it was a member of the former group.

Treasury and the Service intend to amend the regulations under § 1502 to incorporate the guidance set forth in this notice. Until the regulations are amended, taxpayers may rely on the guidance set forth in this notice.

For further information regarding this notice contact David Kessler or Christopher M. Bass of the Office of Associate Chief Counsel (Corporate) at (202) 622-7770 (not a toll-free call).

Part IV. Items of General Interest

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Stoppenhagen, Larry	Ft. Wayne, IN	CPA	April 14, 2000 to April 13, 2001
Chon, James	N. Hollywood, CA	CPA	May 22, 2000 to May 21, 2003
Bleyer, Stephen A.	Bala Cynwyd, PA	CPA	June 26, 2000 to December 25, 2000
Knutson, Owen	Ouray, CO	CPA	July 3, 2000 to January 2, 2003
Silverman, Richard E.	Fayetteville, NY	CPA	August 1, 2000 to March 31, 2004
Holt, Jeffrey	Little Rock, AR	Enrolled Agent	October 1, 2000 to March 31, 2003
Barbagallo, Joseph	Newton, PA	CPA	October 15, 2000 to October 14, 2004

Announcement of the Disbarment and Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under Section 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear in the weekly Bulletin for five successive weeks or as long as it is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Luebben, William	Hot Springs, AR	CPA	February 11, 2000

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 Contributions Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List[1]

Bulletins 2000–27 through 2000–37

[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2000–1 through 2000–26 is in Internal Revenue Bulletin 2000–27, dated July 3, 2000.

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

Bulletins 2000–27 through 2000–37

Notices:

87–76
Obsoleted by
T.D. 8897, 2000–36 I.R.B. *234*

88–24
Obsoleted by
T.D. 8897, 2000–36 I.R.B. *234*

88–86
Obsoleted by
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