Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2000–43, page 333.

Charitable contributions; S corporations; section 170(a)(2). An accrual-basis S corporation may not elect under section 170(a)(2) of the Code to treat a charitable contribution as paid in the year authorized by the S corporation's board of directors if the contribution is paid by the S corporation after the close of the tax year.

Rev. Rul. 2000–44, page 336.

Transactions between partner and partnership. A corporation that acquires assets of another corporation in a transaction described in section 381(a) of the Code succeeds to the status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of section 707(a)(2)(B).

Rev. Rul. 2000–45, page 337.

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for October 2000.

Rev. Rul. 2000–46, page 334.

LIFO; price indexes; department stores. The August 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, August 31, 2000.

T.D. 8902, page 323.

Final regulations interpret the look-through provisions of section 1(h) of the Code (relating to collectibles and section 1250 capital gain) when an interest in a pass-thru entity is sold or exchanged and provide rules for dividing the holding period of an interest in a partnership.

ADMINISTRATIVE

Rev. Proc. 2000–39, page 340.

***Per diem* allowances.** This procedure provides optional rules for deeming substantiated the amount of certain reimbursed traveling expenses of an employee as well as for determining the amount of deductible meals while traveling away from home. Rev. Proc. 2000–9 superseded. Notice 2000–48 superseded.

Announcement 2000–81, page 348.

This document contains corrections to final regulations (T.D. 8892, 2000–32 I.R.B. 158) relating to the removal of temporary regulations concerning the Telefile Voice Signature test.

Announcement 2000–83, page 348.

New Form 8869, *Qualified Subchapter S Subsidiary Election*, is now available. This form is used by a parent S corporation to elect to treat one or more of its eligible subsidiaries as a qualified subchapter S subsidiary (QSub).

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

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.

Actions Relating to Decisions of the Tax Court

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

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

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

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

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

The Commissioner ACQUIESCES in the following decision:

Kathy A. King v. Commissioner,[1]
115 T.C. No. 8

[1] Acquiescence relating to whether a nonpetitioning spouse (or former spouse) is entitled to notice and an opportunity to become a party within the meaning of I.R.C. section 6015(e)(4) in a deficiency case where the petitioning spouse (or former spouse) is claiming relief from joint and several liability under section 6015.

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

Section 1.—Tax Imposed

26 CFR 1.1(h)–1: Capital gains look-through rule for sales or exchanges of interests in a partnership, S corporation, or trust.

T.D. 8902

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

Capital Gains, Partnership, Subchapter S, and Trust Provisions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to sales or exchanges of interests in partnerships, S corporations, and trusts. The regulations interpret the look-through provisions of section 1(h), added by section 311 of the Taxpayer Relief Act of 1997 and amended by sections 5001 and 6005(d) of the Internal Revenue Service Restructuring and Reform Act of 1998, and explain the rules relating to the division of the holding period of a partnership interest. The regulations affect partnerships, partners, S corporations, S corporation shareholders, trusts, and trust beneficiaries.

DATES: *Effective Date*: These regulations are effective September 21, 2000.

FOR FURTHER INFORMATION CONTACT: Jeanne M. Sullivan or David J. Sotos (202) 622-3050 (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 1545-1654. Responses to these collections of information are required to verify compliance with section 1(h) and to determine that the tax on capital gains has been computed correctly.

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

The estimated annual burden per respondent/recordkeeper is 10 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden 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

Section 311 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 788, 831) (the 1997 Act), as modified by sections 5001 and 6005(d) of the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105-206 (112 Stat. 685, 787, 800) (the 1998 Act), reduced the maximum statutory tax rates for long-term capital gains of individuals in general and provided regulatory authority to apply the rules to sales and exchanges of interests in pass-thru entities and to sales and exchanges by pass-thru entities. On August 9, 1999, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–106527–98, 1999–34 I.R.B. 304 [64 F.R. 43117]) relating to the taxation of capital gains in the case of sales or exchanges of interests in partnerships, S corporations, and trusts. The regulations interpreted rules added by the 1997 Act and amended by the 1998 Act, and provided guidance relating to the division of the holding period of a partnership interest. The IRS received no requests to speak at a public hearing that was scheduled for November 18, 1999, and canceled the hearing. Written comments were received in response to the notice of proposed rulemaking. After consideration of the comments, the proposed regulations under sections 1(h), 741, and 1223 are adopted, as revised by this Treasury decision. The comments received and revisions made are discussed below.

Explanation of Revisions and Summary of Comments

1. *Look-Through Capital Gain*

a. In General

Section 1(h) provides maximum capital gains rates in three categories: 20-percent rate gain, 25-percent rate gain, and 28-percent rate gain. Twenty percent rate gain is net capital gain from the sale or exchange of capital assets held for more than one year, reduced by the sum of 25-percent rate gain and 28-percent rate gain. Twenty-five percent rate gain is limited to unrecaptured section 1250 gain. Twenty-eight percent rate gain includes capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to section 408(m)(3)) held for more than one year and certain other types of gain.

Capital gain attributable to the sale or exchange of an interest in a pass-thru entity held for more than one year generally is in the 20-percent rate gain category. However, the proposed regulations provide that, when a taxpayer sells or exchanges an interest in a partnership, S corporation, or trust that holds collectibles, rules similar to the rules under section 751(a) apply to determine the capital gain that is attributable to certain unrealized gain in the collectibles. Furthermore, under the proposed regulations, rules similar to the rules under section 751(a) also apply to determine the capital gain attributable to certain unrealized gain in section 1250 property held by a partnership when a taxpayer sells or exchanges an interest in a partnership that holds such property.

b. Net Collectibles Loss

Twenty-eight percent rate gain is the excess (if any) of (i) the sum of collectibles gain and section 1202 gain, over

(ii) the sum of collectibles loss, the net short-term loss, and the amount of long-term capital loss carried under section 1212(b)(1)(B) to the taxable year. One commentator suggested that, when an interest in a partnership, S corporation, or trust is transferred, net collectibles loss as well as net collectibles gain in property held by such an entity should be taken into account in determining a taxpayer's overall collectibles gain or collectibles loss. The Treasury Department (Treasury) and the IRS believe that the proposed regulations are consistent with the rule in section 1(h)(6)(B), which, in providing look-through treatment with respect to collectibles, refers only to "gain from the sale of an interest in a partnership, S corporation, or trust which is attributable to unrealized appreciation in the value of collectibles . . ." Accordingly, the comment is not adopted in the final regulations.

c. Limitations with Respect to Section 1231 Property

Section 1(h)(7)(B) limits the amount of unrecaptured section 1250 gain recognized as a consequence of sales, exchanges, and conversions described in section 1231(a)(3)(A) to the taxpayer's net section 1231 gain (as defined in section 1231(c)(3)) for the taxable year. The proposed regulations provide that, upon a partner's transfer of a partnership interest, the partner's allocable share of section 1250 capital gain (as defined in §1.1(h)-1(b)(3)) is not treated as section 1231 gain for purposes of applying the limitation in section 1(h)(7)(B). There has been some confusion regarding whether the section 1(h)(7)(B) limitation applies to all unrecaptured section 1250 gain, including section 1250 capital gain recognized on the transfer of a partnership interest.

Because the transfer of an interest in a partnership is not described in section 1231(a)(3)(A), the limitation provided in section 1(h)(7)(B) is not applicable with respect to such transfers. Accordingly, under the final regulations (and consistent with the proposed regulations), where a partner sells an interest in a partnership, the partner must take into account the entire allocable share of section 1250 capital gain in determining the unrecaptured section 1250 gain under section 1(h)(7)(A), without regard to the limitation set forth in section 1(h)(7)(B).

d. Redemption of a Partnership Interest

Some practitioners have expressed concern that the look-through capital gains provisions of the proposed regulations apply to the redemption of a partnership interest. To apply the regulations in the context of redemptions, it would be necessary to import the concepts utilized in section 751(b). Treasury and the IRS believe that this would not be advisable. Accordingly, these regulations do not apply to any transaction that is treated as a redemption of a partnership interest for Federal income tax purposes.

e. Allocating Section 704(c) Gain and Loss

Certain commentators requested that the final regulations provide guidance with respect to the proportionate part of the section 704(c) built-in gain or loss that is transferred to the purchaser when a section 704(c) partner sells a portion of a partnership interest. This issue is relevant because, in determining a taxpayer's share of collectibles gain or section 1250 capital gain on the sale of a partnership interest, it is necessary to calculate how much of such gain would be allocated with respect to the partnership interest sold if the underlying collectibles or section 1250 property held by the partnership were sold for their fair market value. In making this determination where a partner sells only a portion of its interest in a partnership, it is necessary to determine how much section 704(c) gain relating to collectibles or section 1250 property is allocable to the portion of the partnership interest that is sold. Although relevant, Treasury and the IRS believe that this issue is beyond the scope of these regulations. Accordingly, this comment is not addressed in these regulations.

f. Look-Through Capital Gain Where the Pass-Thru Entity Has a Short-Term Holding Period in Collectibles

The final regulations modify the proposed regulations to provide that a pass-thru entity's holding period in the collectibles is not relevant in determining whether long-term capital gain recognized on the sale of an interest in the entity is collectibles gain (taxable at a 28-percent rate). Consistent with the purpose of the look-through provisions contained in section 1(h), these regulations characterize a transferor's long-term capital gain recognized on the sale of the interest in a pass-thru entity by reference to the entity's underlying assets that give rise to such gain. Where a transferor recognizes long-term capital gain on the sale of an interest in a partnership, S corporation, or trust, it would be anomalous to provide the transferor with a better tax result if the entity has a short-term holding period in collectibles than if the entity has a long-term holding period in such property. This rule is not relevant with respect to section 1250 property. Because all depreciation with respect to section 1250 property held for one year or less is treated as additional depreciation under section 1250(b)(1), such amounts will be treated as unrealized receivables under section 751(c) and thus will give rise to ordinary income under section 751(a) upon a disposition of the partnership interest.

2. *Determination of Holding Period in a Partnership*

a. In General

The proposed regulations provide rules relating to the allocation of a divided holding period with respect to an interest in a partnership. These rules generally provide that the holding period of a partnership interest will be divided if a partner acquires portions of an interest at different times or if an interest is acquired in a single transaction that gives rise to different holding periods under section 1223. Under the proposed regulations, the holding period of a portion of a partnership interest generally is determined based on a fraction that is equal to the fair market value of the portion of the partnership interest to which the holding period relates (determined immediately after the acquisition) over the fair market value of the entire partnership interest.

Under the proposed regulations, a selling partner generally cannot identify and use the actual holding period for a portion of the partner's interest. However, the proposed regulations provide that a selling partner is permitted to identify the portion of a partnership interest sold with its holding period if the partnership is a

publicly traded partnership (as defined under section 7704(b)), the partnership interest is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the interest transferred.

b. Contributions of Cash by Existing Partners

The proposed regulations include an example of a pro rata contribution of cash by partners that results in a divided holding period in those partners' interests in the partnership. Commentators suggested that it is inappropriate to provide for a divided holding period where an existing partner contributes cash to the partnership, particularly where the contribution is pro rata by all of the partners. According to these commentators, such an approach may unfairly convert portions of long-term appreciation of partnership assets into a short-term capital gain on the sale of a long held partnership interest. (This conversion occurs regardless of whether the partner sells all or a portion of a partnership interest.)

The conversion of long-term appreciation in partnership assets into short-term capital gain upon the sale of a partnership interest as a result of cash contributions to the partnership is largely the product of partners having unitary bases in their partnership interests. See Rev. Rul. 84-53 (1984-1 C.B. 159) (a partner has a single basis in a partnership interest). Under this rule, gain attributable to previously contributed or acquired assets may be allocated to the short-term portion of a partnership interest even though the value of the short-term portion is no greater than the amount of cash contributed to the partnership. If basis from contributed cash or property could be traced to a segregated interest in the partnership, this conversion of long-term capital appreciation into short-term capital gain would not occur. Larger problems would arise, however, in the context of partnership taxation if a partner were allowed to have a divided basis in a partnership interest.

An aggregate approach to determining the holding period of an interest in a partnership would make it more likely that a contribution of cash would not give rise to a short-term holding period. Under an aggregate approach, one could trace contributed funds into the partnership and determine whether a new holding period was created by reference to whether the funds were used for capital expenditures (in which circumstance, a short-term holding period generally would be appropriate) or for operating expenditures of the partnership (in which circumstance, no new holding period should be created). On the other hand, to the extent that a partnership interest is a capital asset that is distinct from the partnership's assets (an entity approach), its holding period and basis should be determined independently and should not be affected by the partnership's use of the contributed funds. In choosing the entity approach in the proposed regulations, Treasury and the IRS concluded that tracing funds to their ultimate use in the partnership is not an administrable means of determining whether a contribution to a partnership creates a new holding period.

Furthermore, the proposed regulations are consistent with general rules relating to the holding period of capital and section 1231 assets. Where a capital asset (including a capital asset held for one year or less) or property described in section 1231 is contributed to a partnership, section 1223(1) requires the tacking of the holding period in the partnership interest, whether the partners make pro rata contributions of property or instead make non-pro rata contributions that increase the proportionate interests of one or more partners.

In addition, the proposed regulations avoid inappropriate results that may occur if cash contributions are ignored after the formation of a partnership. If cash contributions were ignored, it would be possible for partners to form shelf partnerships with nominal cash contributions in order to start their holding period in the interests, where the majority of cash would not be contributed (and significant operating assets of the partnership would not be acquired) until some time in the future. This clearly would not be a proper result.

Based upon the foregoing, Treasury and the IRS continue to believe that the approach taken in the proposed regulations is appropriate. However, in response to comments, Treasury and the IRS have provided one exception, and explicitly grant authority for another, where the contribution of cash will not create a new holding period in a partnership interest.

If a partner makes cash contributions and receives cash distributions from a partnership during the one-year period before sale of all or a portion of the interest in the partnership, Treasury and the IRS believe it is appropriate that the net cash contribution to the partnership determine the portion of the interest that is held for one year or less. Therefore, the final regulations provide that, if a partner makes one or more cash contributions and receives one or more cash distributions with respect to the partnership during the one-year period ending on the date of the sale or exchange of all or a portion of the partner's interest in the partnership, in applying the rules for determining the partner's holding period in its partnership interest with respect to cash contributions, the partner may reduce the cash contributions made during the year by cash distributions received on a last-in-first-out basis, treating all cash distributions as if they were received by the partner immediately before the sale or exchange. This rule also applies in determining the holding period of a partnership interest where gain or loss is recognized under section 731(a) upon a distribution by the partnership.

In addition, the final regulations include authority for the Secretary to provide, in published guidance, additional exceptions to the general holding period rules with respect to other cash contributions, including *de minimis* cash contributions, to a partnership. Treasury and the IRS request comments as to the appropriate level for a *de minimis* exception.

c. Treatment of Deemed Cash Contributions under Section 752(a)

Section 752(a) provides that an increase in a partner's share of partnership liabilities, or an increase in a partner's individual liabilities by reason of the partner's assumption of partnership liabilities, shall be treated as a contribution of money by the partner to the partnership. Some practitioners have questioned whether a partner's deemed contribution of cash under section 752(a) will give rise to a new holding period in that partner's interest in the partnership. A deemed contribution of cash resulting from a shift among partners in their share of liabilities or as a result of a partnership incurring new debt does not expand the net asset base of the partners represented by their

interests in the partnership. Accordingly, it is inappropriate to create a new holding period as a result of such deemed contributions. However, to the extent that a partner actually assumes a debt of the partnership, thus causing an increase in the net asset base of the partnership, the creation of a new holding period with respect to a portion of the partner's interest is appropriate.

In addressing a similar issue, the capital account rules regarding the treatment of liabilities under §1.704–1(b)(2)(iv)(c) attempt to measure the increase or decrease in a partner's economic interest in the partnership resulting from the assumption of liabilities by either the partner or the partnership. Those rules provide:

> (1) money contributed by a partner to a partnership includes the amount of any partnership liabilities that are assumed by such partner (other than [certain] liabilities . . . that are assumed by a distributee partner [in connection with a distribution of property by the partnership]) but does not include increases in such partner's share of partnership liabilities (see section 752(a)), and (2) money distributed to a partner by a partnership includes the amount of such partner's individual liabilities that are assumed by the partnership (other than [certain] liabilities . . . that are assumed by the partnership [in connection with a contribution of property to the partnership]) but does not include decreases in such partner's share of partnership liabilities (see section 752(b)). . .

This rule is incorporated in the final regulations. The final regulations provide that deemed contributions and distributions of cash under sections 752(a) and (b) will be disregarded in determining a partner's holding period in its partnership interest to the same extent that such amounts are disregarded under §1.704–1(b)(2)(iv)(c). (Deemed distributions under section 752(b) are relevant as a result of the cash netting rule added in these final regulations.)

d. Contribution of Section 751 Assets

Commentators noted that, if a partner has a short-term holding period in a partnership interest on account of the contribution of assets described in section 751(c) or (d) (section 751 assets), the rules of section 751(a) in conjunction with the proposed regulations cause the section 751 assets to be counted twice if a partnership interest is sold within 12 months of the contribution, once in applying section 751(a) to treat part of the amount received as ordinary income, and again in determining the selling partner's short-term capital gain. In response to these comments, the final regulations provide that, if a partner recognizes ordinary income or loss on account of section 751 assets, either under section 751(a) as a result of the sale of all or part of the partnership interest or as a result of the sale by the partnership of the section 751 assets, the section 751 assets shall be disregarded in determining the division of the holding period of an interest in a partnership upon a sale of such partnership interest during the one-year period following the contribution. This rule does not apply if, in the absence of the rule, a partner would not be treated as having held any portion of the interest for more than one year. Accordingly, if a partner's only contributions to a partnership are contributions of section 751 assets or section 751 assets and cash within the prior one-year period, the adjustment will not be available, and the partner appropriately will be treated as having a short-term holding period with respect to the entire interest.

A similar rule disregarding the contribution of section 751 assets does not apply in determining the holding period of a partnership interest with respect to gain or loss recognized under section 731 upon a distribution by a partnership. Properly coordinating the holding period rules with gain or loss determinations under section 751(b) would be inordinately complex. In addition, where, within a one-year period, a partner contributes section 751 assets to a partnership and receives a cash distribution large enough to require the recognition of gain, it is likely that the contribution and distribution will constitute a disguised sale of the section 751 assets to the partnership under section 707(a)(2)(B), thus rendering the holding period rules irrelevant since the sale of an asset to a partnership does not affect the holding period of an interest in the partnership.

e. Treatment of Recapture and Other Unrealized Receivables

An example in the proposed regulations treats the portion of a contributed asset that would be recaptured as ordinary income under section 1245 upon disposition as non-section 1231 property for purposes of the tacked holding period rule in section 1223(1). Some commentators have raised questions regarding the position taken in this example. For purposes of these regulations, Treasury and the IRS believe that it is appropriate to characterize all properties and potential gain treated as unrealized receivables under section 751(c) and the regulations thereunder as separate assets that are not capital assets or property described in section 1231. Accordingly, while the example in the proposed regulations has been eliminated, a specific rule has been added in the final regulations to provide for such a result. This rule is consistent with the rule added in the final regulations regarding the holding period exception for contributed section 751 assets. As discussed above, that rule will disregard the contribution of section 751 assets (including properties and potential gain treated as unrealized receivables under section 751(c)) in computing the holding period of a partnership interest where the interest is sold within one year after contribution. Accordingly, while section 1245 recapture (and similar items treated as unrealized receivables) will be treated as a separate asset that is not a capital or section 1231 asset, the asset will not give rise to a short-term holding period where a partnership interest is sold. This rule also is similar to the rule contained in § 1.755–1(a), which provides that properties and potential gain treated as unrealized receivables under section 751(c) are considered separate ordinary income assets for purposes of allocating basis adjustments under section 755.

f. Identification of Publicly Traded Partnership Units

The proposed regulations provide that a selling partner may use the actual holding period of the portion of a partnership interest sold if the partnership is a "publicly traded partnership" (as defined under section 7704(b)), the partnership interest is divided into identifiable units with ascertainable holding periods, and the selling partner can identify the portion of the interest transferred. Commentators suggested that it may be appropriate to provide that a partner must be consistent in electing, for holding period purposes, to identify units of a publicly traded partnership that are sold or exchanged in order to avoid distortion in the total long-term and short-term capital

gain recognized. This suggestion is adopted in the final regulations.

g. Conversion from General Partnership to Limited Partnership

A commentator requested clarification that a partner's holding period in its partnership interest carries over when a partnership converts from a general partnership to a limited partnership, as described in Rev. Rul. 84-52 (1984–1 C.B. 157). The ruling concludes that, pursuant to section 1223(1), there will be no change to the holding period of any partner's interest in the partnership as a result of such a conversion. The final regulations do not change the result set forth in Rev. Rul. 84-52.

h. Other Miscellaneous Issues

The proposed regulations contain an example which, consistent with Rev. Rul. 84–53, states that a partner has a single basis in its partnership interest. Certain commentators suggested that the principle that a partner has a single basis in its partnership interest should be set forth in regulations, rather than simply relying on Rev. Rul. 84–53. The rules set forth in these regulations address only holding period and character issues. In illustrating the operation of certain of these rules, the example accurately reflects current law. Treasury and the IRS believe that the inclusion of a separate rule providing that a partner has a single basis in its partnership interest is unnecessary and is beyond the scope of these regulations.

Finally, it was suggested that the final regulations cross-reference section 83(f), which provides that in determining the holding period of property to which section 83(a) applies, only the holding period during which rights are transferable or are not subject to a substantial risk of forfeiture shall be included. Treasury and the IRS currently are studying the extent to which section 83(a) applies to the issuance of certain partnership interests (i.e., a profits interest in a partnership) in exchange for services. Section 83(f) is relevant to the extent that section 83(a) applies with respect to a partnership interest. However, in order to avoid any implication that section 83(a) applies to all partnership interests issued in exchange for services, a cross reference to section 83(f) has not been included in the final regulations.

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 impact on a substantial number of small businesses. This certification is based upon the fact that the economic burden imposed on taxpayers by the collection of information and recordkeeping requirements of these regulations is insignificant. For example, the estimated average annual burden per respondent is 10 minutes. Therefore, a Regulatory Flexibility Analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). 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 authors of these regulations are Jeanne M. Sullivan and David J. Sotos of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from Treasury and the IRS participated in their development.

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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 is amended by adding an entry in numerical order to read in part as follows:

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

Section 1.1(h)–1 is also issued under 26 U.S.C. 1(h); * * *

Par. 2. Section 1.1(h)–1 is added to read as follows:

§1.1(h)–1 Capital gains look-through rule for sales or exchanges of interests in a partnership, S corporation, or trust.

(a) *In general*. When an interest in a partnership held for more than one year is sold or exchanged, the transferor may recognize ordinary income (e.g., under section 751(a)), collectibles gain, section 1250 capital gain, and residual long-term capital gain or loss. When stock in an S corporation held for more than one year is sold or exchanged, the transferor may recognize ordinary income (e.g., under sections 304, 306, 341, 1254), collectibles gain, and residual long-term capital gain or loss. When an interest in a trust held for more than one year is sold or exchanged, a transferor who is not treated as the owner of the portion of the trust attributable to the interest sold or exchanged (sections 673 through 679) (a non-grantor transferor) may recognize collectibles gain and residual long-term capital gain or loss.

(b) *Look-through capital gain*—(1) *In general*. Look-through capital gain is the share of collectibles gain allocable to an interest in a partnership, S corporation, or trust, plus the share of section 1250 capital gain allocable to an interest in a partnership, determined under paragraphs (b)(2) and (3) of this section.

(2) *Collectibles gain*—(i) *Definition*. For purposes of this section, *collectibles gain* shall be treated as gain from the sale or exchange of a collectible (as defined in section 408(m) without regard to section 408(m)(3)) that is a capital asset held for more than 1 year.

(ii) *Share of collectibles gain allocable to an interest in a partnership, S corporation, or a trust*. When an interest in a partnership, S corporation, or trust held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, the transferor shall recognize as collectibles gain the amount of net gain (but not net loss) that would be allocated to that partner (taking into account any remedial allocation under §1.704–3(d)), shareholder, or beneficiary (to the extent attributable to the portion of the partnership interest, S corporation stock, or trust interest transferred that was held for more than one year) if the partnership, S corporation, or trust transferred all of its collectibles for cash equal to the fair market value of the assets in a fully taxable transaction immediately

before the transfer of the interest in the partnership, S corporation, or trust. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, S corporation, or trust, the same methodology shall apply to determine the collectibles gain recognized by the transferor, except that the partnership, S corporation, or trust shall be treated as transferring only a proportionate amount of each of its collectibles determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of gain realized in the sale or exchange. With respect to the transfer of an interest in a trust, this paragraph (b)(2) applies only to transfers by non-grantor transferors (as defined in paragraph (a) of this section). This paragraph (b)(2) does not apply to a transaction that is treated, for Federal income tax purposes, as a redemption of an interest in a partnership, S corporation, or trust.

(3) *Section 1250 capital gain*—(i) *Definition*. For purposes of this section, *section 1250 capital gain* means the capital gain (not otherwise treated as ordinary income) that would be treated as ordinary income if section 1250(b)(1) included all depreciation and the applicable percentage under section 1250(a) were 100 percent.

(ii) *Share of section 1250 capital gain allocable to interest in partnership*. When an interest in a partnership held for more than one year is sold or exchanged in a transaction in which all realized gain is recognized, there shall be taken into account under section 1(h)(7)(A)(i) in determining the partner's unrecaptured section 1250 gain the amount of section 1250 capital gain that would be allocated (taking into account any remedial allocation under §1.704–3(d)) to that partner (to the extent attributable to the portion of the partnership interest transferred that was held for more than one year) if the partnership transferred all of its section 1250 property in a fully taxable transaction for cash equal to the fair market value of the assets immediately before the transfer of the interest in the partnership. If less than all of the realized gain is recognized upon the sale or exchange of an interest in a partnership, the same methodology shall apply to determine the section 1250 capital gain recognized by the transferor, except that the partnership shall be treated as transferring only a proportionate amount of each section 1250 property determined as a fraction that is the amount of gain recognized in the sale or exchange over the amount of gain realized in the sale or exchange. This paragraph (b)(3) does not apply to a transaction that is treated, for Federal income tax purposes, as a redemption of a partnership interest.

(iii) *Limitation with respect to net section 1231 gain*. In determining a transferor partner's net section 1231 gain (as defined in section 1231(c)(3)) for purposes of section 1(h)(7)(B), the transferor partner's allocable share of section 1250 capital gain in partnership property shall not be treated as section 1231 gain, regardless of whether the partnership property is used in the trade or business (as defined in section 1231(b)).

(c) *Residual long-term capital gain or loss*. The amount of residual long-term capital gain or loss recognized by a partner, shareholder of an S corporation, or beneficiary of a trust on account of the sale or exchange of an interest in a partnership, S corporation, or trust shall equal the amount of long-term capital gain or loss that the partner would recognize under section 741, that the shareholder would recognize upon the sale or exchange of stock of an S corporation, or that the beneficiary would recognize upon the sale or exchange of an interest in a trust (pre-look-through long-term capital gain or loss) minus the amount of look-through capital gain determined under paragraph (b) of this section.

(d) *Special rule for tiered entities.* In determining whether a partnership, S corporation, or trust has gain from collectibles, such partnership, S corporation, or trust shall be treated as owning its proportionate share of the collectibles of any partnership, S corporation, or trust in which it owns an interest either directly or indirectly through a chain of such entities. In determining whether a partnership has section 1250 capital gain, such partnership shall be treated as owning its proportionate share of the section 1250 property of any partnership in which it owns an interest, either directly or indirectly through a chain of partnerships.

(e) *Notification requirements*. Reporting rules similar to those that apply to the partners and the partnership under section 751(a) shall apply in the case of sales or exchanges of interests in a partnership, S corporation, or trust that cause holders of such interests to recognize collectibles gain and in the case of sales or exchanges of interests in a partnership that cause holders of such interests to recognize section 1250 capital gain. See §1.751–1(a)(3).

(f) *Examples.* The following examples illustrate the requirements of this section:

Example 1. Collectibles gain. (i) *A* and *B* are equal partners in a personal service partnership (*PRS*). *B* transfers *B*'s interest in *PRS* to *T* for $15,000 when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted Basis	Market Value
Cash	$ 3,000	$3,000
Loans Owed to Partnership	10,000	10,000
Collectibles	1,000	3,000
Other Capital Assets	6,000	2,000
Capital Assets	7,000	5,000
Unrealized Receivables	0	14,000
Total	$20,000	$32,000

	LIABILITIES AND CAPITAL	
Liabilities	$ 2,000	$ 2,000
Capital:		
A	9,000	15,000
B	9,000	15,000
Total	$20,000	$32,000

(ii) At the time of the transfer, *B* has held the interest in *PRS* for more than one year, and *B*'s basis for the partnership interest is $10,000 ($9,000 plus $1,000, B's share of partnership liabilities). None of the property owned by *PRS* is section 704(c) property. The total amount realized by *B* is $16,000, consisting of the cash received, $15,000, plus $1,000, *B*'s share of the partnership liabilities assumed by T. See section 752. *B*'s undivided one-half interest in *PRS* includes a one-half interest in the partnership's unrealized receivables and a one-half interest in the partnership's collectibles.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $7,000 of ordinary income from the sale of *PRS*'s unrealized receivables. Therefore, *B* will recognize $7,000 of ordinary income with respect to the unrealized receivables. The difference between the amount of capital gain or loss that the partner would realize in the absence of section 751 ($6,000) and the amount of ordinary income or loss determined under §1.751–1(a)(2) ($7,000) is the partner's capital gain or loss on the sale of the partnership interest under section 741. In this case, the transferor has a $1,000 pre-look-through long-term capital loss.

(iv) If *PRS* were to sell all of its collectibles in a fully taxable transaction for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $1,000 of gain from the sale of the collectibles. Therefore, *B* will recognize $1,000 of collectibles gain on account of the collectibles held by *PRS*.

(v) The difference between the transferor's pre-look-through long-term capital gain or loss (-$1,000) and the look-through capital gain determined under this section ($1,000) is the transferor's residual long-term capital gain or loss on the sale of the partnership interest. Under these facts, *B* will recognize a $2,000 residual long-term capital loss on account of the sale or exchange of the interest in *PRS*.

Example 2. Special allocations. Assume the same facts as in *Example 1*, except that under the partnership agreement, all gain from the sale of the collectibles is specially allocated to *B*, and *B* transfers *B*'s interest to *T* for $16,000. All items of income, gain, loss, or deduction of *PRS*, other than the gain from the collectibles, are divided equally between *A* and *B*. Under these facts, *B*'s amount realized is $17,000, consisting of the cash received, $16,000, plus $1,000, *B*'s share of the partnership liabilities assumed by *T*. See section 752. *B* will recognize $7,000 of ordinary income with respect to the unrealized receivables (determined under §1.751–1(a)(2)). Accordingly, *B*'s pre-look-through long-term capital gain would be $0. If *PRS* were to sell all of its collectibles in a fully taxable transaction for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $2,000 of gain from the sale of the collectibles. Therefore, *B* will recognize $2,000 of collectibles gain on account of the collectibles held by *PRS*. *B* will recognize a $2,000 residual long-term capital loss on account of the sale of B's interest in *PRS*.

Example 3. Net collectibles loss ignored. Assume the same facts as in *Example 1*, except that the collectibles held by *PRS* have an adjusted basis of $3,000 and a fair market value of $1,000, and the other capital assets have an adjusted basis of $4,000 and a fair market value of $4,000. (The total adjusted basis and fair market value of the partnership's capital assets are the same as in *Example 1*.) If *PRS* were to sell all of its collectibles in a fully taxable transaction for cash equal to the fair market value of the assets immediately prior to the transfer of *B*'s partnership interest to *T*, *B* would be allocated $1,000 of loss from the sale of the collectibles. Because none of the gain from the sale of the interest in *PRS* is attributable to unrealized appreciation in the value of collectibles held by *PRS*, the net loss in collectibles held by *PRS* is not recognized at the time *B* transfers the interest in *PRS*. *B* will recognize $7,000 of ordinary income (determined under §1.751–1(a)(2)) and a $1,000 long-term capital loss on account of the sale of *B*'s interest in *PRS*.

Example 4. Collectibles gain in an S corporation. (i) A corporation (*X*) has always been an S corporation and is owned by individuals *A*, *B*, and *C*. In 1996, *X* invested in antiques. Subsequent to their purchase, the antiques appreciated in value by $300. *A* owns one-third of the shares of *X* stock and has held that stock for more than one year. *A*'s adjusted basis in the *X* stock is $100. If *A* were to sell all of A's *X* stock to *T* for $150, *A* would realize $50 of pre-look-through long-term capital gain.

(ii) If *X* were to sell its antiques in a fully taxable transaction for cash equal to the fair market value of the assets immediately before the transfer to *T*, *A* would be allocated $100 of gain on account of the sale. Therefore, *A* will recognize $100 of collectibles gain (look-through capital gain) on account of the collectibles held by *X*.

(iii) The difference between the transferor's pre-look-through long-term capital gain or loss ($50) and the look-through capital gain determined under this section ($100) is the transferor's residual long-term capital gain or loss on the sale of the S corporation stock. Under these facts, *A* will recognize $100 of collectibles gain and a $50 residual long-term capital loss on account of the sale of *A*'s interest in *X*.

Example 5. Sale or exchange of partnership interest where part of the interest has a short-term holding period. (i) *A*, *B*, and *C* form an equal partnership (*PRS*). In connection with the formation, *A* contributes $5,000 in cash and a capital asset with a fair market value of $5,000 and a basis of $2,000; *B* contributes $7,000 in cash and a collectible with a fair market value of $3,000 and a basis of $3,000; and *C* contributes $10,000 in cash. At the time of the contribution, *A* had held the contributed property for two years. Six months later, when *A*'s basis in *PRS* is $7,000, *A* transfers *A*'s interest in *PRS* to *T* for $14,000 at a time when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted Basis	Market Value
Cash	$ 22,000	$22,000
Unrealized Receivables	0	6,000
Capital Asset	2,000	5,000
Collectible	3,000	9,000
Capital Assets	5,000	14,000
Total	$ 27,000	$42,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50 percent of the fair market value of *A*'s interest in *PRS* was received in exchange for a capital asset with a long-term holding period. Therefore, 50 percent of *A*'s interest in *PRS* has a long-term holding period. See §1.1223–3(b)(1).

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $2,000 of ordinary income. Accordingly, *A* will recognize $2,000 ordinary income and $5,000 ($7,000 - $2,000) of capital gain on account of the transfer to *T* of *A*'s interest in *PRS*. Fifty percent ($2,500) of that gain is long-term capital gain and 50 percent ($2,500) is short-term capital gain. See §1.1223–3(c)(1).

(iv) If the collectible were sold or exchanged in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $2,000 of gain attributable to the collectible. The gain attributable to the collectible that is allocable to the portion of the transferred interest in *PRS* with a long-term holding period is $1,000 (50 percent of $2,000). Accordingly, *A* will recognize $1,000 of collectibles gain on account of the transfer of *A*'s interest in *PRS*.

(v) The difference between the amount of pre-look-through long-term capital gain or loss ($2,500) and the look-through capital gain ($1,000) is the amount of residual long-term capital gain or loss that *A* will recognize on account of the transfer of *A*'s interest in *PRS*. Under these facts, *A* will recognize a residual long-term capital gain of $1,500 and a short-term capital gain of $2,500.

(g) *Effective date*. This section applies to transfers of interests in partnerships, S corporations, and trusts that occur on or after September 21, 2000.

Par. 3. Section 1.741–1 is amended by adding paragraphs (e) and (f) to read as follows:

§1.741–1 Recognition and character of gain or loss on sale or exchange.

* * * * *

(e) For rules relating to the capital gain or loss recognized when a partner sells or exchanges an interest in a partnership that holds appreciated collectibles or section 1250 property with section 1250 capital gain, see § 1.1(h)–1. This paragraph (e) applies to transfers of interests in partnerships that occur on or after September 21, 2000.

(f) For rules relating to dividing the holding period of an interest in a partnership, see §1.1223–3. This paragraph (f) applies to transfers of partnership interests and distributions of property from a partnership that occur on or after September 21, 2000.

Par. 4. Section 1.1223–3 is added under the undesignated center heading "General Rules for Determining Capital Gains and Losses" to read as follows:

§1.1223–3 Rules relating to the holding periods of partnership interests.

(a) *In general*. A partner shall not have a divided holding period in an interest in a partnership unless—

(1) The partner acquired portions of an interest at different times; or

(2) The partner acquired portions of the partnership interest in exchange for property transferred at the same time but resulting in different holding periods (e.g., section 1223).

(b) *Accounting for holding periods of an interest in a partnership*—(1) *General rule*. The portion of a partnership interest to which a holding period relates shall be determined by reference to a fraction, the numerator of which is the fair market value of the portion of the partnership interest received in the transaction to which the holding period relates, and the denominator of which is the fair market value of the entire partnership interest (determined immediately after the transaction).

(2) *Special rule*. For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged (or with respect to which gain or loss is recognized upon a distribution under section 731), if a partner makes one or more contributions of cash to the partnership and receives one or more distributions of cash from the partnership during the one-year period ending on the date of the sale or exchange (or distribution with respect to which gain or loss is recognized under section 731), the partner may reduce the cash contributions made during the year by cash distributions received on a last-in-first-out basis, treating all cash distributions as if they were received immediately before the sale or exchange (or at the time of the distribution with respect to which gain or loss is recognized under section 731).

(3) *Deemed contributions and distributions*. For purposes of paragraphs (b)(1) and (2) of this section, deemed contributions of cash under section 752(a) and deemed distributions of cash under section 752(b) shall be disregarded to the same extent that such amounts are disregarded under §1.704–1(b)(2)(iv)(c).

(4) *Adjustment with respect to contributed section 751 assets*. For purposes of applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged, if a partner receives a portion of the partnership interest in exchange for property described in section 751(c) or (d) (section 751 assets) within the one-year period ending on the date of the sale or exchange of all or a portion of the partner's interest in the partnership, and the partner recognizes ordinary income or loss on account of such a section 751 asset in a fully taxable transaction (either as a result of the sale of all or part of the partner's interest in the partnership or the sale by the partnership of the section 751 asset), the contribution of the section 751 asset during the one-year period shall be disregarded. However, if, in the absence of this paragraph, a partner would not be treated as having held any portion of the interest for more than one year (e.g., because the partner's only contributions to the partnership are contributions of section 751 assets or section 751 assets and cash within the prior one-year period), this adjustment is not available.

(5) *Exception*. The Commissioner may prescribe by guidance published in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) a rule disregarding certain cash contributions (including contributions of a *de minimis* amount of cash) in applying paragraph (b)(1) of this section to determine the holding period of a partnership interest (or portion thereof) that is sold or exchanged.

(c) *Sale or exchange of all or a portion of an interest in a partnership*—(1) *Sale or exchange of entire interest in a partnership*. If a partner sells or exchanges the partner's entire interest in a partnership, any capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the holding period of the interest in the partnership is divided between the portion of the interest held for more than one year and the portion of the interest held for one year or less.

(2) *Sale or exchange of a portion of an interest in a partnership*—(i) *Certain*

publicly traded partnerships. A selling partner in a publicly traded partnership (as defined under section 7704(b)) may use the actual holding period of the portion of a partnership interest transferred if—

(A) The ownership interest is divided into identifiable units with ascertainable holding periods;

(B) The selling partner can identify the portion of the partnership interest transferred; and

(C) The selling partner elects to use the identification method for all sales or exchanges of interests in the partnership after September 21, 2000. The selling partner makes the election referred to in this paragraph (c)(2)(i)(C) by using the actual holding period of the portion of the partner's interest in the partnership first transferred after September 21, 2000, in reporting the transaction for federal income tax purposes.

(ii) *Other partnerships*. If a partner has a divided holding period in a partnership interest, and paragraph (c)(2)(i) of this section does not apply, then the holding period of the transferred interest shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the transferor partner would realize if the entire interest in the partnership were transferred in a fully taxable transaction immediately before the actual transfer.

(d) *Distributions*—(1) *In general*. Except as provided in paragraph (b)(2) of this section, a partner's holding period in a partnership interest is not affected by distributions from the partnership.

(2) *Character of capital gain or loss recognized as a result of a distribution from a partnership*. If a partner is required to recognize capital gain or loss as a result of a distribution from a partnership, then the capital gain or loss recognized shall be divided between long-term and short-term capital gain or loss in the same proportions as the long-term and short-term capital gain or loss that the distributee partner would realize if such partner's entire interest in the partnership were transferred in a fully taxable transaction immediately before the distribution.

(e) *Section 751(c) assets*. For purposes of this section, properties and potential gain treated as unrealized receivables under section 751(c) shall be treated as separate assets that are not capital assets as defined in section 1221 or property described in section 1231.

(f) Examples. The provisions of this section are illustrated by the following examples:

Example 1. Division of holding period—contribution of money and a capital asset. (i) *A* contributes $5,000 of cash and a nondepreciable capital asset *A* has held for two years to a partnership (*PRS*) for a 50 percent interest in *PRS*. *A*'s basis in the capital asset is $5,000, and the fair market value of the asset is $10,000. After the exchange, *A*'s basis in *A*'s interest in *PRS* is $10,000, and the fair market value of the interest is $15,000. *A* received one-third of the interest in *PRS* for a cash payment of $5,000 ($5,000/$15,000). Therefore, *A*'s holding period in one-third of the interest received (attributable to the contribution of money to the partnership) begins on the day after the contribution. *A* received two-thirds of the interest in *PRS* in exchange for the capital asset ($10,000/$15,000). Accordingly, pursuant to section 1223(1), *A* has a two-year holding period in two-thirds of the interest received in *PRS*.

(ii) Six months later, when *A*'s basis in *PRS* is $12,000 (due to a $2,000 allocation of partnership income to *A*), *A* sells the interest in *PRS* for $17,000. Assuming *PRS* holds no inventory or unrealized receivables (as defined under section 751(c)) and no collectibles or section 1250 property, *A* will realize $5,000 of capital gain. As determined above, one-third of *A*'s interest in *PRS* has a holding period of one year or less, and two- thirds of *A*'s interest in *PRS* has a holding period equal to two years and six months. Therefore, one-third of the capital gain will be short-term capital gain, and two-thirds of the capital gain will be long-term capital gain.

Example 2. Division of holding period—contribution of section 751 asset and a capital asset. A contributes inventory with a basis of $2,000 and a fair market value of $6,000 and a capital asset which *A* has held for more than one year with a basis of $4,000 and a fair market value of $6,000, and *B* contributes cash of $12,000 to form a partnership (*AB*). As a result of the contribution, one-half of *A*'s interest in *AB* is treated as having been held for more than one year under section 1223(1). Six months later, *A* transfers one-half of *A*'s interest in *AB* to *C* for $6,000, realizing a gain of $3,000. If *AB* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $4,000 of ordinary income on account of the inventory. Accordingly, *A* will recognize $2,000 of ordinary income and $1,000 of capital gain ($3,000 - $2,000) on account of the transfer to *C*. Because *A* recognizes ordinary income on account of the inventory that was contributed to *AB* within the one year period ending on the date of the sale, the inventory will be disregarded in determining the holding period of *A*'s interest in *AB*. All of the capital gain will be long-term.

Example 3. Netting of cash contributions and distributions. (i) On January 1, 2000, *A* holds a 50 percent interest in the capital and profits of a partnership (*PS*). The value of *A*'s *PS* interest is $900, and *A*'s holding period in the entire interest is long-term. On January 2, 2000, when the value of *A*'s *PS* interest is still $900, *A* contributes $100 to *PS*. On June 1, 2000, *A* receives a distribution of $40 cash from the partnership. On September 1, 2000, when the value of *A*'s interest in *PS* is $1,350, *A* contributes an additional $230 cash to *PS*, and on October 1, 2000, *A* receives another $40 cash distribution from *PS*. *A* sells *A*'s entire partnership interest on November 1, 2000, for $1,600. *A*'s adjusted basis in the *PS* interest at the time of the sale is $1,000.

(ii) For purposes of netting cash contributions and distributions in determining the holding period of *A*'s interest in *PS*, *A* is treated as having received a distribution of $80 on November 1, 2000. Applying that distribution on a last-in-first-out basis to reduce prior contributions during the year, the contribution made on September 1, 2000, is reduced to $150 ($230 - $80). The holding period then is determined as follows: Immediately after the contribution of $100 on January 2, 2000, *A*'s holding period in *A*'s *PS* interest is 90 percent long-term ($900/($900 + $100)) and 10 percent short-term ($100/($900 + $100)). The contribution of $150 on September 1, 2000, causes 10 percent of *A*'s partnership interest ($150/($1,350 + $150)) to have a short-term holding period. Accordingly, immediately after the contribution on September 1, 2000, *A*'s holding period in *A*'s *PS* interest is 81 percent long-term (.90 x .90) and 19 percent short-term ((.10 x .90) + .10). Accordingly, $486 ($600 x .81) of the gain from *A*'s sale of the *PS* interest is long-term capital gain, and $114 ($600 x .19) is short-term capital gain.

Example 4. Division of holding period when capital account is increased by contribution. A, B, C, and *D* are equal partners in a partnership (*PRS*), and the fair market value of a 25 percent interest in *PRS* is $100. *A, B, C,* and *D* each contribute an additional $100 to partnership capital, thereby increasing the fair market value of each partner's interest to $200. As a result of the contribution, each partner has a new holding period in the portion of the partner's interest in *PRS* that is attributable to the contribution. That portion equals 50 percent ($100/$200) of each partner's interest in *PRS*.

Example 5. Sale or exchange of a portion of an interest in a partnership. (i) *A, B,* and *C* form an equal partnership (*PRS*). In connection with the formation, *A* contributes $5,000 in cash and a capital asset (capital asset 1) with a fair market value of $5,000 and a basis of $2,000; *B* contributes $7,000 in cash and a capital asset (capital asset 2) with a fair market value of $3,000 and a basis of $3,000; and *C* contributes $10,000 in cash. At the time of the contribution, *A* had held the contributed property for two years. Six months later, when *A*'s basis in *PRS* is $7,000, *A* transfers one-half of *A*'s interest in *PRS* to *T* for $7,000 at a time when *PRS*'s balance sheet (reflecting a cash receipts and disbursements method of accounting) is as follows:

	ASSETS	
	Adjusted Basis	Market Value
Cash	$ 22,000	$22,000
Unrealized Receivables	0	6,000
Capital Asset 1	2,000	5,000
Capital Asset 2	3,000	9,000
Capital Assets	5,000	14,000
Total	$ 27,000	$42,000

(ii) Although at the time of the transfer *A* has not held *A*'s interest in *PRS* for more than one year, 50 percent of the fair market value of *A*'s interest in *PRS* was received in exchange for a capital asset with a long-term holding period. Therefore, 50 percent of *A*'s interest in *PRS* has a long-term holding period.

(iii) If *PRS* were to sell all of its section 751 property in a fully taxable transaction immediately before *A*'s transfer of the partnership interest, *A* would be allocated $2,000 of ordinary income. One-half of that amount ($1,000) is attributable to the portion of *A*'s interest in *PRS* transferred to *T*. Accordingly, *A* will recognize $1,000 ordinary income and $2,500 ($3,500 - $1,000) of capital gain on account of the transfer to *T* of one-half of *A*'s interest in *PRS*. Fifty percent ($1,250) of that gain is long-term capital gain and 50 percent ($1,250) is short-term capital gain.

Example 6. Sale of units of interests in a partnership. A publicly traded partnership (*PRS*) has ownership interests that are segregated into identifiable units of interest. *A* owns 10 limited partnership units in *PRS* for which *A* paid $10,000 on January 1, 1999. On August 1, 2000, *A* purchases five additional units for $10,000. At the time of purchase, the fair market value of each unit has increased to $2,000. *A*'s holding period for one-third ($10,000/$30,000) of the interest in *PRS* begins on the day after the purchase of the five additional units. Less than one year later, *A* sells five units of ownership in *PRS* for $11,000. At the time, *A*'s basis in the 15 units of *PRS* is $20,000, and *A*'s capital gain on the sale of 5 units is $4,333 (amount realized of $11,000 - one-third of the adjusted basis or $6,667). For purposes of determining the holding period, *A* can designate the specific units of *PRS* sold. If *A* properly identifies the five units sold as five of the ten units for which A has a long-term holding period and elects to use the identification method for all subsequent sales or exchanges of interests in the partnership by using the actual holding period in reporting the transaction on *A*'s federal income tax return, the capital gain realized will be long-term capital gain.

Example 7. Disproportionate distribution. In 1997, *A* and *B* each contribute cash of $50,000 to form and become equal partners in a partnership (*PRS*). More than one year later, *A* receives a distribution worth $22,000 from *PRS*, which reduces *A*'s interest in *PRS* to 36 percent. After the distribution, *B* owns 64 percent of *PRS*. The holding periods of *A* and *B* in their interests in *PRS* are not affected by the distribution.

Example 8. Gain or loss as a result of a distribution—(i) On January 1, 1996, *A* contributes property with a basis of $10 and a fair market value of $10,000 in exchange for an interest in a partnership (*ABC*). On September 30, 2000, when *A*'s interest in *ABC* is worth $12,000 (and the basis of *A*'s partnership interest is still $10), *A* contributes $12,000 cash in exchange for an additional interest in *ABC*. *A* is allocated a loss equal to $10,000 by *ABC* for the taxable year ending December 31, 2000, thereby reducing the basis of *A*'s partnership interest to $2,010. On February 1, 2001, *ABC* makes a cash distribution to *A* of $10,000. *ABC* holds no inventory or unrealized receivables. (Assume that *A* is allocated no gain or loss for the taxable year ending December 31, 2001, so that the basis of *A*'s partnership interest does not increase or decrease as a result of such allocations.)

(ii) The netting rule contained in paragraph (b)(2) of this section provides that, in determining the holding period of *A*'s interest in *ABC*, the cash contribution made on September 30, 2000, must be reduced by the distribution made on February 1, 2001. Accordingly, for purposes of determining the holding period of *A*'s interest in *ABC*, *A* is treated as having made a cash contribution of $2,000 ($12,000 - $10,000) to *ABC* on September 30, 2000. *A*'s holding period in one-seventh of *A*'s interest in *ABC* ($2,000 cash contributed over the $14,000 value of the entire interest (determined as if only $2,000 were contributed rather than $12,000)) begins on the day after the cash contribution. *A* recognizes $7,990 of capital gain as a result of the distribution. See section 731(a)(1). One-seventh of the capital gain recognized as a result of the distribution is short-term capital gain, and six-sevenths of the capital gain is long-term capital gain. After the distribution, *A*'s basis in the interest in *PRS* is $0, and the holding period for the interest in *PRS* continues to be divided in the same proportions as before the distribution.

(g) *Effective date*. This section applies to transfers of partnership interests and distributions of property from a partnership that occur on or after September 21, 2000.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 6. In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
1.1(h)–1(e)	1545-1654
* * * * *	

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 20, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 21, 2000, 65 F.R. 57092)

Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

Rules are set forth under which a reimbursement or other expense allowance arrangement for the cost of lodging, meal, and incidental expenses or meal and incidental expenses incurred by an employee while traveling away from home will satisfy the requirement of § 62 (c) of the Code as to substantiation of the amount of the expenses. See Rev. Proc. 2000–39, page 340.

Section 162.—Trade or Business Expenses

26 CFR 1.162–17: Reporting and substantiation of certain business expenses of employees.

Rules are set forth for substantiating the amount of a deduction or an expense for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home. See Rev. Proc. 2000–39, page 340.

Section 170.—Charitable, Etc., Contributions and Gifts

(Also § 1366.)

Charitable contributions; S corporations; section 170(a)(2). This ruling provides that an accrual-basis S corporation may not elect under section 170(a)(2) to treat a charitable contribution as paid in the year authorized by the S corporation's board of directors if the contribution is paid by the S corporation after the close of the tax year.

Rev. Rul. 2000–43

ISSUE

May an accrual-basis subchapter S corporation elect under § 170(a)(2) of the Internal Revenue Code to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year and before the 15th day of the third month following the close of the taxable year?

FACTS

Taxpayer is the sole shareholder of an accrual-basis subchapter S corporation. The S corporation reports on a calendar year period. On December 31, 1999, the S corporation's Board of Directors authorized a charitable contribution to Charity, a qualified donee under § 170(c)(2) and an organization described under § 501(c)(3). The S corporation paid the charitable contribution to Charity on March 1, 2000.

LAW AND ANALYSIS

Section 170(a)(1) allows as a deduction any charitable contribution (as defined in § 170(c)) the payment of which is made within the taxable year. Under § 170(b)(1), the percentage limitation on charitable contributions for an individual is 50 percent, 30 percent, or 20 percent of the taxpayer's contribution base (generally adjusted gross income) for the taxable year, depending generally on the type of property contributed and the type of qualified donee. Under § 170(b)(2), the percentage limitation on charitable contributions by a corporation is 10 percent of the taxpayer's taxable income with certain adjustments.

Under § 170(a)(2), a corporation reporting its taxable income on the accrual basis may elect to deduct a charitable contribution in the year in which the board of directors authorizes the contribution, if the payment is made by the 15th day of the third month following the close of the taxable year. The election may be made only at the time of the filing of the return for the taxable year and is made by reporting the contribution on the return. See § 1.170A–11(b)(2) of the Income Tax Regulations.

The legislative history to § 170(a)(2) provides that the exception for accrual basis corporations was desirable because corporations intending to make the maximum charitable contribution allowable as a deduction had experienced difficulty in determining before the end of the taxable year what constituted 5 percent of their net income (the § 170(b) gross income limitation for corporations at the time of enactment). S. Rep. No. 831, 81st Cong., 1st Sess. at 1949–2 C.B. 289, 290–1.

Section 1363(b) states that the taxable income of an S corporation is computed in the same manner as in the case of an individual with certain exceptions, among which is an exception that the deductions referred to in § 703(a)(2) are not allowed to the corporation. Section 703(a)(2)(C) specifically refers to the deduction for charitable contributions provided in § 170.

Section 1366(a)(1)(A) provides that in determining the tax of a shareholder, each shareholder takes into account the shareholder's pro rata share of the corporation's items of income (including tax-exempt income), loss, deduction or credit, the separate treatment of which could affect any shareholder's tax liability. Section 1366(a)(1) provides further that the items referred to in § 1366(a)(1)(A) include amounts described in § 702(a)(4). Section 702(a)(4) refers to charitable contributions (as defined in § 170(c)).

Section 1.1366–1(a)(2)(iii) provides that the separately stated items of a subchapter S corporation include charitable contributions, grouped by the percentage limitations of § 170(b), paid by the corporation within the taxable year of the corporation.

The legislative history of § 1366 states that the corporate limitation on charitable contributions will no longer apply. Instead, charitable contributions by S corporations will pass through to the shareholders and be subject to the individual limitations on deductibility. See H.R. Rep. No. 826, 97th Cong., 2d Sess. 14 (1982); S. Rep. No. 640, 97th Cong., 2d Sess. 16 (1982).

Under § 1363(b), a subchapter S corporation computes its taxable income in the same manner as an individual. The election in § 170(a)(2) is not available to an individual. An individual taxpayer may deduct a

charitable contribution only in the year in which payment is actually made to the charitable organization. Furthermore, the rationale behind § 170(a)(2), a corporation's difficulty in determining its charitable contribution limit under § 170(b)(2), does not apply to subchapter S corporations because a subchapter S corporation is not subject to the same § 170(b)(2) limit.

Accordingly, under the facts described above, the S corporation must report the charitable contribution on its tax return for the year in which it actually paid the charitable contribution, the taxable year ending December 31, 2000.

HOLDING

An accrual-basis subchapter S corporation may not elect under § 170(a)(2) to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year.

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin Schäffer of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Martin Schäffer at (202) 622-3080 (not a toll-free call).

Section 267.—Losses, Expenses, and Interest With Respect to Transactions Between Related Taxpayers

26 CFR 1.267 (a)–1: Deductions disallowed.

When a payor provides a per diem allowance to an employee who is a related party, the rules set forth for the deemed substantiation to the payor of the amount of the employee's ordinary and necessary business expenses for lodging, meal, and incidental expenses incurred while traveling away from home do not apply. See Rev. Proc. 2000–39, page 340.

Section 274.—Disallowance of Certain Entertainment, etc., Expenses

26 CFR 1.274–5: Substantiation requirements.

Rules are set forth for an optional method for substantiating the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or meal and incidental expenses incurred while traveling away from home when a payor provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expense paid or incurred while traveling away from home. See Rev. Proc. 2000–39, page 340.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

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

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

LIFO; price indexes; department stores. The August 2000 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, August 31, 2000.

Rev. Rul. 2000–46

The following Department Store Inventory Price Indexes for August 2000 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, August 31, 2000.

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

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

Groups	Aug. 1999	Aug. 2000	Percent Change from Aug. 1999 to Aug. 2000[1]
1. Piece Goods	546.1	509.2	-6.8
2. Domestics and Draperies	630.1	617.9	-1.9
3. Women's and Children's Shoes	635.3	618.3	-2.7
4. Men's Shoes	882.3	913.2	3.5
5. Infants' Wear	623.9	619.8	-0.7
6. Women's Underwear	550.7	570.2	3.5
7. Women's Hosiery	322.1	334.7	3.9
8. Women's and Girls' Accessories	528.1	532.0	0.7
9. Women's Outerwear and Girls' Wear	377.6	370.5	-1.9
10. Men's Clothing	609.9	605.4	-0.7
11. Men's Furnishings	610.6	612.9	0.4
12. Boys' Clothing and Furnishings	473.3	473.0	-0.1
13. Jewelry	962.0	936.5	-2.7
14. Notions	793.9	785.9	-1.0
15. Toilet Articles and Drugs	971.6	971.0	-0.1
16. Furniture and Bedding	679.3	687.9	1.3
17. Floor Coverings	602.1	603.2	0.2
18. Housewares	788.2	778.5	-1.2
19. Major Appliances	234.8	230.9	-1.7
20. Radio and Television	65.7	58.8	-10.5
21. Recreation and Education[2]	97.0	92.2	-4.9
22. Home Improvements[2]	127.6	129.2	1.3
23. Auto Accessories[2]	106.8	106.2	-0.6
Groups 1 - 15: Soft Goods	589.9	585.3	-0.8
Groups 16 - 20: Durable Goods	447.4	437.2	-2.3
Groups 21 - 23: Misc. Goods[2]	102.9	99.8	-3.0
Store Total[3]	536.9	529.7	-1.3

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

[2] Indexes on a January 1986=100 base.

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

DRAFTING INFORMATION

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

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 707.—Transactions Between Partner and Partnership

26 CFR 1.707–3: Disguised sales of property to partnership; general rules.

(Also §§ 381, 707, 721, 731, 752; 1.707–3, 1.707–4, 1.707–5.)

This ruling provides that a corporation that acquires assets of another corporation in a transaction described in § 381(a) of the Code succeeds to the status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B)

Rev. Rul. 2000–44

ISSUE

Does a corporation that acquires assets of another corporation in a transaction described in § 381(a) of the Internal Revenue Code succeed to the status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B)?

FACTS

Corporation *P* owns all of the stock of corporation *S*. *S* has only one asset, rental property, that is encumbered by a nonrecourse liability of $40*x* originally incurred by *S* on January 1, 1995. *S* incurred $5*x* in capital expenditures with respect to the rental property on December 1, 1998.

On January 1, 1999, *S* distributes the rental property, subject to the $40*x* liability, to *P* in a transaction that qualifies as a complete liquidation of *S* within the meaning of § 332.

On January 1, 2000, *P* contributes the rental property, subject to the $40*x* liability, to a partnership (*PRS*) in exchange for an interest in *PRS*. In connection with the transaction, *PRS* reimburses *P* $5*x* for the capital expenditures incurred by *S* with respect to the contributed property. At the time that *P* transfers the rental property to *PRS*, the rental property has a fair market value of $100*x* and an adjusted basis of $70*x*.

LAW

Section 721(a) provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 731(a)(1) provides that in the case of a distribution by a partnership to a partner, gain shall not be recognized to the partner, except to the extent that any money distributed exceeds the adjusted basis of the partner's interest in the partnership immediately before the distribution.

Section 752(b) provides that any decrease in a partner's share of the liabilities of a partnership, or any decrease in a partner's individual liabilities by reason of the assumption by the partnership of the individual liabilities, shall be considered as a distribution of money to the partner by the partnership.

Section 707(a)(2)(B) provides that if (i) there is a direct or indirect transfer of money or other property by a partner to a partnership, (ii) there is a related direct or indirect transfer of money or other property by the partnership to the partner (or another partner), and (iii) the transfers when viewed together are properly characterized as a sale or exchange of property, then the transfers shall be treated either as a transaction between the partnership and a partner not acting in the partner's capacity as a partner or as a transaction between two or more partners acting other than in their capacity as partners.

Section 1.707–3(a) of the Income Tax Regulations provides that, except as otherwise provided in § 1.707–3, if a transfer of property by a partner to a partnership and one or more transfers of money or other consideration by the partnership to the partner constitute a sale based on all the facts and circumstances, the transfers are treated as a sale of property to the partnership.

Section 1.707–3(c)(1) provides that if within a 2-year period a partner transfers property to a partnership and the partnership transfers money or other consideration to the partner (without regard to the order of the transfers), the transfers are presumed to be a sale of the property to the partnership unless the facts and circumstances clearly establish that the transfers do not constitute a sale.

Section 1.707-4(d) provides that, in general, notwithstanding the presumption relating to transfers made within 2 years of each other, a transfer of money or other consideration by the partnership to a partner is not treated as part of a sale of property by the partner to the partnership under § 1.707-3(a) to the extent that the transfer to the partner by the partnership is made to reimburse the partner for, and does not exceed the amount of, capital expenditures that (1) are incurred during the 2-year period preceding the transfer by the partner to the partnership; and (2) are incurred by the partner with respect to (i) partnership organization and syndication costs described in § 709; or (ii) property contributed to the partnership by the partner, but only to the extent the reimbursed capital expenditures do not exceed 20 percent of the fair market value of the property at the time of the contribution (preformation expenditures).

Section 1.707-5(a)(1) provides that for purposes of the disguised sale rules, if a partnership assumes or takes property subject to a qualified liability, as defined in

§ 1.707-5(a)(6), the partnership is treated as transferring consideration to the partner only to the extent that the transfer of property to the partnership is otherwise treated as part of a sale. By contrast, if the partnership assumes or takes property subject to a liability of the partner other than a qualified liability, the partnership is treated as transferring consideration to the partner to the extent that the amount of the liability exceeds the partner's share of that liability immediately after the partnership assumes or takes subject to the liability as provided in § 1.707-5(a)(2), (3), and (4).

Under § 1.707-5(a)(6), a qualified liability is (1) a liability that was incurred by the partner more than 2 years prior to the earlier of the date the partner agrees in writing to transfer the property or the

date the partner transfers the property to the partnership and that has encumbered the transferred property throughout that 2-year period; (2) a liability that was incurred within the 2-year period that has encumbered the transferred property since it was incurred, so long as the liability was not incurred in anticipation of the transfer of the property to a partnership; (3) a liability that is allocable under the rules of § 1.163–8T of the temporary Income Tax Regulations to capital expenditures with respect to the property; or (4) a liability that was incurred in the ordinary course of the trade or business in which property transferred to the partnership was used or held but only if all the assets related to that trade or business are transferred other than assets that are not material to a continuation of the trade or business. Certain additional limitations apply with respect to recourse liabilities. See § 1.707–5(a)(6)(ii).

Under § 1.707–4(e), the Commissioner may provide by guidance published in the Internal Revenue Bulletin situations in addition to those specifically addressed in the regulations where payments or transfers to a partner will not be treated as part of a disguised sale.

Section 381(a) references certain transactions that involve one corporation acquiring assets of another corporation in a tax-free transfer (that is, liquidations under § 332, reorganizations under § 368(a)(1)(A), (C), and (F), and certain nondivisive reorganizations under § 368(a)(1)(D) and (G)).

ANALYSIS

The rules regarding preformation expenses and qualified liabilities contained in the disguised sale regulations recognize that certain expenditures will be made, and certain liabilities will be incurred, under circumstances that do not violate the disguised sale rules. Where a corporation incurs preformation expenses or undertakes a borrowing, and another corporation acquires assets of the corporation in a § 381 transaction, the transfer does not alter the circumstances under which the expenditures or indebtedness were originally incurred or otherwise raise concerns that would justify not treating the transferee corporation as having incurred the expenditures or undertaken the liabilities at the time they were incurred or undertaken by the predecessor corporation.

Transactions enumerated in § 381(a) involve situations where the transferor corporation is absorbed by the transferee corporation in a tax-free transaction. Given the purposes for the rules relating to preformation expenses and qualified liabilities, it is appropriate that, in transactions described in § 381(a), the transferee corporation will succeed to the status of the distributor or transferor corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability.

Accordingly, under the facts presented, *P* will succeed to the status of *S* for purposes of determining whether the $5*x* cash reimbursement from *PRS* qualifies for the exception for reimbursements of preformation expenditures under § 1.707–4(d). *S* incurred $5*x* in capital expenditures with respect to the rental property on December 1, 1998, which is within the 2-year period preceding the transfer of the property to *PRS*. The reimbursed capital expenditures do not exceed 20 percent of the fair market value of the contributed property. Thus, the $5*x* cash reimbursement from *PRS* to *P* for the capital expenditures incurred by *S* with respect to the rental property falls within the exception for reimbursement of preformation expenditures and will not give rise to a disguised sale between *P* and *PRS* under § 707(a)(2)(B) and the regulations.

P also will succeed to the status of *S* for purposes of determining whether the $40*x* liability is a qualified liability within the meaning of § 1.707–5(a)(6). The $40*x* liability encumbering the property was incurred by *S* on January 1, 1995, which is more than 2 years prior to the date the rental property was contributed to *PRS*. Accordingly, the $40*x* liability is a qualified liability within the meaning of § 1.707-5(a)(6). As a result, the fact that *P* transfers the rental property to *PRS* subject to the liability will not give rise to a disguised sale between *P* and *PRS* under § 707(a)(2)(B) and the regulations.

HOLDING

A corporation that acquires assets of another corporation in a transaction described in § 381(a) will succeed to status of the other corporation for purposes of applying the exception for reimbursements of preformation expenditures and determining whether a liability is a qualified liability under the regulations regarding the disguised sale provisions of § 707(a)(2)(B).

DRAFTING INFORMATION

The principal author of this revenue ruling is Shannon Cohen of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Shannon Cohen at (202) 622-3050 (not a toll-free call).

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

Federal rates; adjusted federal rates; adjusted federal long-term rate, and the long-term exempt rate. For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for October 2000.

Rev. Rul. 2000–45

This revenue ruling provides various prescribed rates for federal income tax purposes for October 2000 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term ad-

justed applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2000–45 TABLE 1
Applicable Federal Rates (AFR) for October 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	6.30%	6.20%	6.15%	6.12%
110% AFR	6.94%	6.82%	6.76%	6.73%
120% AFR	7.58%	7.44%	7.37%	7.33%
130% AFR	8.22%	8.06%	7.98%	7.93%
Mid-Term				
AFR	6.09%	6.00%	5.96%	5.93%
110% AFR	6.71%	6.60%	6.55%	6.51%
120% AFR	7.33%	7.20%	7.14%	7.09%
130% AFR	7.95%	7.80%	7.73%	7.68%
150% AFR	9.20%	9.00%	8.90%	8.84%
175% AFR	10.78%	10.50%	10.37%	10.28%
Long-Term				
AFR	5.96%	5.87%	5.83%	5.80%
110% AFR	6.56%	6.46%	6.41%	6.37%
120% AFR	7.16%	7.04%	6.98%	6.94%
130% AFR	7.78%	7.63%	7.56%	7.51%

REV. RUL. 2000–45 TABLE 2
Adjusted AFR for October 2000

	Period for Compounding			
	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	4.30%	4.25%	4.23%	4.21%
Mid-term adjusted AFR	4.52%	4.47%	4.45%	4.43%
Long-term adjusted AFR	5.33%	5.26%	5.23%	5.20%

REV. RUL. 2000–45 TABLE 3

Rates Under Section 382 for October 2000

Adjusted federal long-term rate for the current month	5.33%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.53%

REV. RUL. 2000–45 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for October 2000

Appropriate percentage for the 70% present value low-income housing credit	8.41%
Appropriate percentage for the 30% present value low-income housing credit	3.60%

REV. RUL. 2000–45 TABLE 5

Rate Under Section 7520 for October 2000

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	7.4%

Section 1288.—Treatment of Original Issue Discounts on Tax-1 Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 1366.—Pass-Thru of Items to Shareholders

26 CFR 1.1366–1: Shareholder's share of items of an S corporation.

May an accrual-basis subchapter S corporation elect under § 170(a)(2) of the Internal Revenue Code to treat a charitable contribution as paid in the year authorized by the S corporation's Board of Directors if the contribution is paid by the S corporation after the close of the taxable year and before the 15th day of the third month following the close of the taxable year? See Rev. Rul. 2000–43, page 333.

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Section 7872.—Treatment of Loans with Below-Market Interest Rates

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of October 2000. See Rev. Rul. 2000–45, page 337.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, sections 62, 162, 267, 274; 1.62-2, 1.162-17, 1.267(a)-1, 1.274-5.)

Rev. Proc. 2000-39

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 2000-9, 2000-2 I.R.B. 280, by providing rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under § 1.274-5 of the Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a *per diem* allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of such travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of service limitations of the Department of Transportation, § 274(n)(3) gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008. For taxable years beginning in 2000 or 2001, the deductible percentage for these expenses is 60 percent.

.03 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 for any traveling expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.04 Section 1.274-5(g) of the regulations, in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or *per diem* allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such arrangements or allowances, if in accordance with reasonable business practice, will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel expenses for purposes of § 1.274-5(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of such travel expenses for purposes of § 1.274-5(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.07 Under § 1.62-2(c)(1) a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62-2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274-5(g) or 1.274-5(j)(1) will be treated as substantiation of the amount of such expenses for purposes of § 1.62-2. Under § 1.62-2(f)(2), the Commissioner may prescribe rules under which an arrangement providing *per diem* allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to days of travel not substantiated.

.08 Section 1.62-2(h)(2)(i)(B) provides that if a payor pays a per diem allowance

that meets the requirements of § 1.62-2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62-2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274-5(g) or § 1.274-5(j)(1), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)-3, 31.3231(e)-1(a)(5), 31.3306(b)-2, and 31.3401(a)-4 of the Employment Tax Regulations. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62-2(g) (relating to the return of excess amounts) do not apply to this portion.

.09 Under § 1.62-2(h)(2)(i)(B)(*4*), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on *per diem* allowances.

.10 Section 1.274-5(j)(1) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Section 5.04 of this revenue procedure contains revisions to the list of high-cost localities and to the high-low rates for purposes of section 5.

.12 Section 6.07 of this revenue procedure contains a revision to the related party rules.

.13 Sections 3.02, 4.04(5), and 5.06 provide transition rules for the last 3 months of calendar year 2000 due to changes in the effective date of the CONUS rates published by GSA.

SECTION 3. DEFINITIONS

.01 *Per diem allowance*. The term "*per diem* allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62-2(c)(1) and that is

(1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses or for meal and incidental expenses for travel away from home in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate and federal M&IE rate.*

(1) *General rule*. The federal *per diem* rate is equal to the sum of the applicable federal lodging expense rate and the applicable federal meal and incidental expense (M&IE) rate for the day and locality of travel.

(a) *CONUS rates*. The rates for localities in the continental United States ("CONUS") are set forth in Appendix A to 41 C.F.R. ch. 301. However, in applying section 4.01, 4.02, or 4.03 of this revenue procedure, taxpayers may continue to use the CONUS rates in effect for the first 9 months of 2000 for expenses of all CONUS travel while away from home that are paid or incurred during calendar year 2000 in lieu of the updated GSA rates. A taxpayer must consistently use either these rates or the updated rates for the period of October 1, 2000, through December 31, 2000.

(b) *OCONUS rates*. The rates for localities outside the continental United States ("OCONUS") are established by the Secretary of Defense (rates for non-foreign localities, including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States) and by the Secretary of State (rates for foreign localities), and are published in the Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas) (updated on a monthly basis).

(c) *Internet access to the rates*. The CONUS and OCONUS rates may be found on the Internet at www.policyworks.gov/perdiem.

(2) *Locality of travel*. The term "locality of travel" means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses*. The term "incidental expenses" includes, but is not limited to, expenses for laundry, cleaning and pressing of clothing, and fees and tips for services, such as for porters and baggage carriers. The term "incidental expenses" does not include taxicab fares, lodging taxes, or the costs of telegrams or telephone calls.

.03 *Flat rate or stated schedule.*

(1) *In general*. Except as provided in section 3.03(2) of this revenue procedure, an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01 of this revenue procedure. Such allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (*e.g.*, cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation*. For purposes of this revenue procedure, an allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62-2(d), is not a *per diem* allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance, or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62-2(d)(3)(ii).

SECTION 4. PER DIEM SUBSTANTIATION METHOD

.01 *Per diem allowance*. If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal,

and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal *per diem* rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meals only per diem allowance.* If a payor pays a *per diem* allowance only for meal and incidental expenses in lieu of reimbursing actual expenses for meal and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the *per diem* allowance for such day or the amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure). A *per diem* allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meals only deduction.* In lieu of using actual expenses, employees and self-employed individuals, in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, may use an amount computed at the federal M&IE rate (see section 3.02 of this revenue procedure) for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee or self-employed individual is away from home. Such amount will be deemed substantiated for purposes of paragraphs (b)(2) (travel away from home) and (c) of § 1.274-5, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel expenses in accordance with those regulations.

.04 *Special rules for transportation industry.*

(1) *In general.* This section 4.04 applies to (a) a payor that pays a *per diem* allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Rates.* A taxpayer described in section 4.04(1) of this revenue procedure may treat $38 as the federal M&IE rate for any locality of travel in CONUS, and/or $42 as the federal M&IE rate for any locality of travel OCONUS. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. See section 4.04(5) of this revenue procedure for transition rules.

(3) *Periodic rule.* A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue procedure periodically (not less frequently than monthly), rather than daily, by comparing the total *per diem* allowance paid for the period to the sum of the amounts computed at the federal M&IE rate(s) for the localities of travel for the days (or partial days, see section 6.04 of this revenue procedure) the employee is away from home during the period. For example, assume an employee in the transportation industry travels away from home within CONUS on 17 days (including partial days, see section 6.04 of this revenue procedure) during a calendar month and receives a *per diem* allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(2) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total *per diem* allowance paid for the month or $646 (17 days at $38 per day).

(4) *Transportation industry defined.* For purposes of this section 4.04 of this revenue procedure, an employee or self-employed individual is "in the transportation industry" only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is "in the transportation industry" by using a method that is consistently applied and in accordance with reasonable business practice.

(5) *Transition rules.* Under the calendar-year convention provided in section 4.04(2), a taxpayer who used the federal M&IE rates during the first 9 months of calendar year 2000 to substantiate the amount of an individual's travel expenses under sections 4.02 or 4.03 of Rev. Proc. 2000-9 may not use, for that individual, the special transportation industry rates provided in this section 4.04 until January 1, 2001. Similarly, a taxpayer who used the special transportation industry rates during the first 9 months of calendar year 2000 to substantiate the amount of an individual's travel expenses may not use, for that individual, the federal M&IE rates until January 1, 2001.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *General rule.* If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred

by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the expenses that is deemed substantiated for each calendar day is equal only substantiation method provided in section 4.02 or 4.03 of this revenue procedure.

.02 *Specific high-low rates*. Except as provided in section 5.06 of this revenue procedure, the *per diem* rate set forth in this section 5.02 is $201 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $124 for travel to any other locality within CONUS. Whichever *per diem* rate applies, it is applied as if it were the federal *per diem* rate for the locality of travel. For purposes of applying the high-low substantiation method and the § 274(n) limitation on meal expenses (see section 6.05 of this revenue procedure), the federal M&IE rate shall be treated as $42 for a high-cost locality and $34 for any other locality within CONUS.

.03 *High-cost localities*. The following localities have a federal *per diem* rate of $163 or more, and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parenthesis under the key city name, except as provided in section 5.06 of this revenue procedure:

Key city	*County or other defined location*
California	
Palm Springs (January 1-May 31)	Riverside
San Francisco	San Francisco
Sunnyvale/Palo Alto/San Jose	Santa Clara
Tahoe City	Placer
Colorado	
Aspen (January 1-April 30)	Pitkin
Silverthorne/Keystone	Summit
Telluride (January 1-March 31)	San Miguel
Vail (July 1-March 31)	Eagle
District of Columbia	
Washington, D.C.	Washington, D.C.; the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, in Virginia; and the counties of Montgomery and Prince George's in Maryland
Florida	
Key West (January 1-April 30)	Monroe
Idaho	
Sun Valley	City limits of Sun Valley
Illinois	
Chicago	Cook and Lake
Louisiana	
New Orleans/St. Bernard (January 1-May 31)	Orleans, St. Bernard, Plaquemine, and Jefferson Parishes
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Ocean City (June 15-October 31)	Worcester
Massachusetts	
Boston	Suffolk
Cambridge	Middlesex County (except Lowell)
Martha's Vineyard (June 1-October 15)	Dukes

Michigan	
Mackinac Island	Mackinac
Traverse City (June 1-September 30)	Grand Traverse
Montana	
Big Sky (November 1-April 30)	Gallatin (except West Yellowstone Park)
New Jersey	
Cape May (June 1-November 30)	Cape May (except Ocean City)
Ocean City (June 15-September 15)	City limits of Ocean City
Piscataway/Belle Mead	Somerset and Middlesex
Princeton/Trenton	Mercer County
New York	
The Bronx/Brooklyn/Queens	The boroughs of The Bronx, Brooklyn, and Queens
Manhattan	Manhattan
Nassau County/Great Neck	Nassau County
Suffolk County	Suffolk County
White Plains	City limits of White Plains
Pennsylvania	
Hershey (June 1-September 15)	City limits of Hershey
Philadelphia	Philadelphia
Utah	
Park City (December 15-March 31)	Summit
Virginia (For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia)	
Wintergreen	Nelson

.04 *Changes in high-cost localities.* The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 2000-9.

(1) The following localities (listed by key cities) have been added to the list of high-cost localities: Palm Springs, California; New Orleans/St. Bernard, Louisiana; Traverse City, Michigan; Trenton, New Jersey; and Wintergreen, Virginia.

(2) The portion of the year for which the following are high-cost localities (listed by key cities) has been changed: Aspen, Colorado; Telluride, Colorado; Vail, Colorado; Key West, Florida; Sun Valley, Idaho; Ocean City, Maryland; Martha's Vineyard, Massachusetts; Big Sky, Montana; Cape May, New Jersey; and Park City, Utah.

(3) The following localities (generally listed by key cities) have been removed from the list of high-cost localities: Charlevoix, Michigan, and Union County, New Jersey.

.05 *Specific limitation.*

(1) Except as provided in section 5.05(2) of this revenue procedure, a payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. See section 5.06 of this revenue procedure for transition rules.

(2) With respect to an employee described in section 5.05(1) of this revenue procedure, the payor may reimburse actual expenses or use the meals only *per diem* method described in section 4.02 of this revenue procedure for any travel away from home, and may use the *per diem* substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

.06 *Transition rules.* A payor who used the substantiation method of section 4.01 of Rev. Proc. 2000-9 for an employee during the first 9 months of calendar year 2000 may not use the High-Low Substantiation Method in section 5 of this revenue procedure for that employee until January 1, 2001. A payor who used the High-Low Substantiation Method of section 5 of Rev. Proc. 2000-9 for an employee during the first 9 months of calendar year 2000 must continue to use the High-Low Substantiation Method for the remainder of calendar year 2000 for that employee. A payor described in the previous sentence may use the rates and high-cost localities published in section 5 of Rev. Proc. 2000-9, in lieu of the updated rates and high-cost localities provided in section 5 of this

revenue procedure, for travel on or after October 1, 2000, and before January 1, 2001, if those rates and localities are used consistently during this period for all employees reimbursed under this method.

SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general.* The federal *per diem* rate and the federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301-11 (2000), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate.* A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the requirement that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate.* A payor is not required to reduce the federal *per diem* rate or the federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee.

.04 *Proration of the federal per diem or M&IE rate.* Pursuant to the Federal Travel Regulations, in determining the federal *per diem* rate or the federal M&IE rate for the locality of travel, the full applicable federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. For purposes of determining the amount deemed substantiated under section 4 or 5 of this revenue procedure with respect to partial days of travel away from home, either of the following methods may be used to prorate the federal M&IE rate to determine the federal *per diem* rate or the federal M&IE rate for the partial days of travel:

(1) Such rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual; or

(2) Such rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to 2 times the federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only 1 1/2 times the federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses.* All or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) When an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat such amount as an expense for food and beverages.

(2) When a *per diem* allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) When a *per diem* allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the federal M&IE rate for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, when a *per diem* allowance for lodging, meal, and incidental expenses is paid at a rate that is less than the federal *per diem* rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure), the payor may treat an amount equal to 40 percent of such allowance as the federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.06 *No double reimbursement or deduction.* If a payor pays a *per diem* allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses or for meal and incidental expenses in accordance with section 4 or 5 of this revenue procedure, any additional payment with respect to such expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to such expenses. For example, assume an employee receives a *per diem* allowance from a payor for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a *per diem* allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes.

.07 *Related parties.* Sections 4.01 and 5 of this revenue procedure will not apply in any case in which a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) shall be 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place, and business purpose of the

travel expenses in accordance with paragraphs (b)(2) (travel away from home) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274-5, the employee is deemed to satisfy the adequate accounting requirements of § 1.274-5(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274-5(c). See § 1.62-2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.02 An arrangement providing *per diem* allowances will be treated as satisfying the requirement of § 1.62-2(f)(2) with respect to returning amounts in excess of expenses if the employee is required to return within a reasonable period of time (as defined in § 1.62-2(g)) any portion of such an allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance *per diem* allowance for meal and incidental expenses of $200, based on an anticipated 5 days of business travel at $40 per day to a locality for which the federal M&IE rate is $34, and the employee substantiates 3 full days of business travel. The requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62-2(g)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel ($80), even though the employee is not required to return the portion of the allowance ($18) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($102) for the 3 substantiated days of travel. However, the $18 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a *per diem* allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(f)(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. See § 1.62-2(c)(2) and (c)(4).

.04 An employee is required to include in gross income only the portion of the per diem allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274-5(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See § 1.62-2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the *per diem* allowance received from the payor, and includes in gross income the portion (if any) of the *per diem* allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274-5(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who does not receive a *per diem* allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.07 A self-employed individual may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n).

.08 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See § 1.62-2(c)(3), (c)(5), and (h)(2).

SECTION 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a *per diem* allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62-2(h)(2)(i)(B).

.02 In the case of a *per diem* allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the pay-

roll period in which the payor reimburses the expenses for the days of travel substantiated. See § 1.62-2(h)(2)(i)(B)(*2*).

.03 In the case of a *per diem* allowance paid as an advance, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the days of travel with respect to which the advance was paid are substantiated. See § 1.622(h)(2)(i)(B)(*3*). If some or all of the days of travel with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those days within a reasonable period of time, the portion of the allowance that relates to those days is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.622(h)(2)-(i)(A).

.04 In the case of a *per diem* allowance only for meal and incidental expenses for travel away from home paid to an employee in the transportation industry by a payor that uses the rule in section 4.04(3) of this revenue procedure, the excess of the *per diem* allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(3) of this revenue procedure), is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62-2(h)(2)(i)(B)(*4*).

.05 For example, assume that an employer pays an employee a *per diem* allowance to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the federal *per diem* rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the federal *per diem* rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the federal *per diem* rate is $100 and 4 days in a locality in which the federal *per diem* rate is $125. The employer reimburses the employee $840 for the 6 days of travel away from home (2 x (120% x $100) + 4 x (120% x $125)), and does not require the employee to return the excess payment of $140 (2 days x $20 ($120-$100) + 4 days x $25 ($150-$125)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on $140. See section 8.02 of this revenue procedure.

SECTION 9. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 2000-9 is hereby superseded (except to the extent specified in sections 4.04(5) and 5.06 of this revenue procedure) for *per diem* allowances that are paid both (1) to an employee on or after October 1, 2000, and (2) with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel while away from home on or after October 1, 2000. Rev. Proc. 2000-9 is also hereby superseded (except to the extent specified in section 4.04(5) of this revenue procedure) for purposes of computing the amount allowable as a deduction for meal and incidental expenses paid or incurred by an employee or self-employed individual for travel while away from home on or after October 1, 2000.

.02 Notice 2000-48, 2000-37 I.R.B. 265, is hereby superseded.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon at (202) 622-4920 (not a toll-free call).

Part IV. Items of General Interest

TeleFile Voice Signature Test; Correction

Announcement 2000–81

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Correction to removal of temporary regulations.

SUMMARY: This document contains corrections to a removal of temporary regulations that provides that an individual Federal income tax return completed as part of the Telefile Voice Signature test will be treated as a return that is signed, authenticated, verified and filed by the taxpayer. This document was published in the Federal Register on July 18, 2000 (65 F.R. 44437).

DATES: This correction is effective July 18, 2000.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Need for Correction

As published, the removal of temporary regulations (TD 8892, 2000–32 I.R.B.158) contains errors that may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the removal of temporary regulations (TD 8892), which is the subject of FR Doc. 00-18116, is corrected as follows:

1. On page 44438, column 1, in amendatory instruction **Par. 6.**, line 1, the language, "**Par. 6.** Section 602.101(c) is amended" is corrected to read "**Par. 6.** Section 602.101(b) is amended". **§602.101 [Corrected]**

2. On page 44438, column 1, the paragraph designation §602.101 (c) is correctly designated §602.101 (b).

Cynthia Grigsby,
Chief, Regulations Unit,
Office of Special Counsel
(Modernization and Strategic Planning).

(Filed by the Office of the Federal Register on September 18, 2000, 8:45 a.m., and published in the issue of the Federal Register for September 19, 2000, 65 F.R. 56484)

New Form 8869, Qualified Subchapter S Subsidiary Election

Announcement 2000-83

New Form 8869 is now available. A parent S corporation uses Form 8869 to elect to treat one or more of its eligible subsidiaries as a qualified subchapter S subsidiary (QSub).

The new form replaces the temporary procedures for filing a QSub election under Notice 97-4, 1997-1 C.B. 351. As a result, Form 966, Corporate Dissolution or Liquidation, may no longer be used to make a QSub election.

You can obtain Form 8869 by telephone or by using IRS electronic information services.

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Definition of Terms

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

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

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

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

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

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in 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.

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