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. 2002–13, page 637.
Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning April 1, 2002, will be 6 percent for overpayments (5 percent in the case of a corporation), 6 percent for underpayments, and 8 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 3.5 percent.

Rev. Rul. 2002–14, page 636.
LIFO; price indexes; department stores. The January 2002 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, January 31, 2002.

REG–118861–00, page 651.
Proposed regulations apply to a deemed sale or acquisition of an insurance company's assets pursuant to an election under section 338 of the Code, to a sale or acquisition of an insurance trade or business subject to section 1060, and to the acquisition of insurance contracts through assumption reinsurance. The regulations also concern the effect under section 381 of certain corporate liquidations and reorganizations on certain tax attributes of insurance companies. The regulations apply to insurance companies and to corporations selling and purchasing stock of insurance companies. A public hearing is scheduled for September 18, 2002.

Notice 2002–18, page 644.
Loss duplication. The IRS announces that regulations will be issued to prevent duplication of losses within a consolidated group on dispositions of member stock.

EXEMPT ORGANIZATIONS

Announcement 2002–32, page 664.
A list is provided of organizations now classified as private foundations.

ADMINISTRATIVE

REG–107366–00, page 645.
Proposed regulations under section 7433 of the Code relate to civil causes of action for damages caused by unlawful collection actions of officers and employees of the IRS and the awarding of costs and certain fees. The regulations reflect amendments made by the Taxpayer Bill of Rights 2 and the IRS Restructuring and Reform Act of 1998.

Announcement 2002–33, page 666.
This document withdraws proposed regulations (REG–251502–96, 1998–1 C.B. 621) relating to section 7433 of the Code. The proposed regulations implemented provisions of the Taxpayer Bill of Rights 2 (TBOR2). New proposed regulations containing provisions of both TBOR2 and the IRS Restructuring and Reform Act of 1998 are published in this Bulletin (REG–107366–00).

Announcement 2002–35, page 667.
This document contains a correction to the advance notice of proposed regulations (Announcement 2002–9, 2002–7 I.R.B. 536) that clarifies the application of section 263(a) of the Code to expenditures incurred in acquiring, creating, or enhancing certain intangible assets or benefits.

Finding Lists begin on page ii.

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 Other Related Items, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

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

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

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

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

LIFO; price indexes; department stores. The January 2002 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, January 31, 2002.

Rev. Rul. 2002–14

The following Department Store Inventory Price Indexes for January 2002 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, January 31, 2002.

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	Jan. 2001	Jan. 2002	Percent Change from Jan. 2001 to Jan. 2002[1]
1.	Piece Goods	490.8	479.8	-2.2
2.	Domestics and Draperies	614.6	588.3	-4.3
3.	Women's and Children's Shoes	628.8	607.3	-3.4
4.	Men's Shoes	886.8	875.0	-1.3
5.	Infants' Wear	609.2	602.2	-1.1
6.	Women's Underwear	556.3	556.8	0.1
7.	Women's Hosiery	343.8	350.3	1.9
8.	Women's and Girls' Accessories	526.9	559.0	6.1
9.	Women's Outerwear and Girls' Wear	369.7	350.2	-5.3
10.	Men's Clothing	586.1	565.6	-3.5
11.	Men's Furnishings	603.2	586.5	-2.8
12.	Boys' Clothing and Furnishings	484.6	467.1	-3.6
13.	Jewelry	956.1	918.2	-4.0
14.	Notions	784.3	770.1	-1.8
15.	Toilet Articles and Drugs	987.1	969.1	-1.8
16.	Furniture and Bedding	685.2	625.9	-8.7
17.	Floor Coverings	630.1	630.4	0.0
18.	Housewares	769.4	757.8	-1.5
19.	Major Appliances	229.9	227.0	-1.3
20.	Radio and Television	56.8	51.9	-8.6

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

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

Groups	Jan. 2001	Jan. 2002	Percent Change from Jan 2001 to Jan. 2002[1]
21. Recreation and Education[2]	91.0	88.1	-3.2
22. Home Improvements[2]	127.7	124.6	-2.4
23. Auto Accessories[2]	108.7	110.5	1.7
Groups 1 — 15: Soft Goods	583.7	566.2	-3.0
Groups 16 — 20: Durable Goods	432.9	417.1	-3.6
Groups 21 — 23: Misc. Goods[2]	99.4	97.5	-1.9
Store Total[3]	527.4	511.5	-3.0

[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 Michael Burkom of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622–7718 (not a toll-free call).

Section 6621.— Determination of Interest Rate

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning April 1, 2002, will be 6 percent for overpayments (5 percent in the case of a corporation), 6 percent for underpayments, and 8 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 will be 3.5 percent.

Rev. Rul. 2002–13

Section 6621 of the Internal Revenue Code establishes the rates for interest on tax overpayments and tax underpayments. Under § 6621(a)(1), the overpayment rate beginning April 1, 2002, is the sum of the federal short-term rate plus 3 percentage points (2 percentage points in the case of a corporation), except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

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

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

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

Section 6621(b)(2)(B) provides that in determining the addition to tax under § 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

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

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of January 2002 is 3 percent. Accordingly, an overpayment rate of 6 percent (5 percent in the case of a corporation) and an underpayment rate of 6 percent are established for the calendar quarter beginning April 1, 2002. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning April 1, 2002, is 3.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning April 1, 2002, is 8 percent. These rates apply to amounts bearing interest during that calendar quarter.

Under § 6621(b)(2)(B), the 6 percent rate that applies to estimated tax underpayments for the first calendar quarter in 2002, as provided in Rev. Rul. 2001–63 (2001–52 I.R.B. 606), also applies to such underpayments for the first 15 days in April 2002.

Interest factors for daily compound interest for annual rates of 3.5 percent, 5 percent, 6 percent, and 8 percent are published in Tables 12, 15, 17, and 21 of Rev. Proc. 95–17 (1995–1 C.B. 556, 566, 569, 571, and 575).

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

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Associate Chief Counsel (Procedure & Administration), Administrative Provisions & Judicial Practice Division. For further information regarding this revenue ruling, contact Mr. Bailey at (202) 622–6226 (not a toll-free call).

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

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

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

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629

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

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B.			1995–1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577

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

	OVERPAYMENTS			UNDERPAYMENTS		
	1995–1 C.B.			1995–1 C.B.		
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577
Apr. 1, 1998—Jun. 30, 1998	7%	19	573	8%	21	575
Jul. 1, 1998—Sep. 30, 1998	7%	19	573	8%	21	575
Oct. 1, 1998—Dec. 31, 1998	7%	19	573	8%	21	575

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

		1995–1 C.B.	
	RATE	TABLE	PAGE
Jan. 1, 1999—Mar. 31, 1999	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	9%	71	625
Oct. 1, 2000—Dec 31, 2000	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	6%	17	571

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

	OVERPAYMENTS			UNDERPAYMENTS		
		1995–1 C.B.			1995–1 C.B.	
	RATE	TABLE	PG	RATE	TABLE	PG
Jan. 1, 1999—Mar. 31, 1999	6%	17	571	7%	19	573
Apr. 1, 1999—Jun. 30, 1999	7%	19	573	8%	21	575
Jul. 1, 1999—Sep. 30, 1999	7%	19	573	8%	21	575
Oct. 1, 1999—Dec. 31, 1999	7%	19	573	8%	21	575
Jan. 1, 2000—Mar. 31, 2000	7%	67	621	8%	69	623
Apr. 1, 2000—Jun. 30, 2000	8%	69	623	9%	71	625
Jul. 1, 2000—Sep. 30, 2000	8%	69	623	9%	71	625
Oct. 1, 2000—Dec. 31, 2000	8%	69	623	9%	71	625
Jan. 1, 2001—Mar. 31, 2001	8%	21	575	9%	23	577
Apr. 1, 2001—Jun. 30, 2001	7%	19	573	8%	21	575
Jul. 1, 2001—Sep. 30, 2001	6%	17	571	7%	19	573
Oct. 1, 2001—Dec. 31, 2001	6%	17	571	7%	19	573
Jan. 1, 2002—Mar. 31, 2002	5%	15	569	6%	17	571
Apr. 1, 2002—Jun. 30, 2002	5%	15	569	6%	17	571

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

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

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

		1995–1 C.B.	
	RATE	TABLE	PAGE
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581
Apr. 1, 1998—Jun. 30, 1998	10%	25	579
Jul. 1, 1998—Sep. 30, 1998	10%	25	579
Oct. 1, 1998—Dec. 31, 1998	10%	25	579
Jan. 1, 1999—Mar. 31, 1999	9%	23	577
Apr. 1, 1999—Jun. 30, 1999	10%	25	579
Jul. 1, 1999—Sep. 30, 1999	10%	25	579
Oct. 1, 1999—Dec. 31, 1999	10%	25	579
Jan. 1, 2000—Mar. 31, 2000	10%	73	627
Apr. 1, 2000—Jun. 30, 2000	11%	75	629
Jul. 1, 2000—Sep. 30, 2000	11%	75	629
Oct. 1, 2000—Dec. 31, 2000	11%	75	629
Jan. 1, 2001—Mar. 31, 2001	11%	27	581
Apr. 1, 2001—Jun. 30, 2001	10%	25	579
Jul. 1, 2001—Sep. 30, 2001	9%	23	577
Oct. 1, 2001—Dec. 31, 2001	9%	23	577
Jan. 1, 2002—Mar. 31, 2002	8%	21	575
Apr. 1, 2002—Jun. 30, 2002	8%	21	575

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

		1995–1 C.B.	
	RATE	TABLE	PAGE
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572

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

		1995–1 C.B.	
	RATE	TABLE	PAGE
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572
Apr. 1, 1998—Jun. 30, 1998	5.5%	16	570
Jul. 1. 1998—Sep. 30, 1998	5.5%	16	570
Oct. 1, 1998—Dec. 31, 1998	5.5%	16	570
Jan. 1, 1999—Mar. 31, 1999	4.5%	14	568
Apr. 1, 1999—Jun. 30, 1999	5.5%	16	570
Jul. 1, 1999—Sep. 30, 1999	5.5%	16	570
Oct. 1, 1999—Dec. 31, 1999	5.5%	16	570
Jan. 1, 2000—Mar. 31, 2000	5.5%	64	618
Apr. 1, 2000—Jun. 30, 2000	6.5%	66	620
Jul. 1, 2000—Sep. 30, 2000	6.5%	66	620
Oct. 1, 2000—Dec. 31, 2000	6.5%	66	620
Jan. 1, 2001—Mar. 31, 2001	6.5%	18	572
Apr. 1, 2001—Jun. 30, 2001	5.5%	16	570
Jul. 1, 2001—Sep. 30, 2001	4.5%	14	568
Oct. 1, 2001—Dec. 31, 2001	4.5%	14	568
Jan. 1, 2002—Mar. 31, 2002	3.5%	12	566
Apr. 1, 2002—Jun. 30, 2002	3.5%	12	566

Part III. Administrative, Procedural, and Miscellaneous

IRS Announces Regulations Will be Issued to Prevent Duplication of Losses Within a Consolidated Group on Dispositions of Member Stock

Notice 2002–18

In Notice 2002–11 (2002–7 I.R.B. 526), the Internal Revenue Service announced its intention to promulgate interim regulations that, prospectively from the date of their issuance, will require consolidated groups to determine the allowable loss on a sale or disposition of subsidiary stock under an amended § 1.337(d)–2 of the Income Tax Regulations.

Concurrently with this Notice, the IRS and Treasury are filing with the Federal Register temporary regulations under §§ 337(d) and 1502 of the Internal Revenue Code that set forth rules governing a consolidated group's allowable loss, or basis reduction, on a disposition or deconsolidation of subsidiary stock, as described in Notice 2002–11. These rules do not disallow stock loss that reflects net operating losses or built-in asset losses of a subsidiary member.

Nonetheless, the IRS and Treasury believe that a consolidated group should not be able to benefit more than once from one economic loss. Accordingly, the IRS and Treasury intend to issue regulations that will prevent a consolidated group from obtaining a tax benefit from both the utilization of a loss from the disposition of stock (or another asset that reflects the basis of stock) and the utilization of a loss or deduction with respect to another asset that reflects the same economic loss. For example, where a member of a group contributes built-in loss assets to another member of the group in exchange for stock of such member in a transaction in which the basis of such stock is determined, directly or indirectly, in whole or in part, by reference to the basis of such assets and the transferor member sells such stock without causing the deconsolidation of the transferee, the group may benefit from the built-in loss in the contributed assets more than once. It is expected that the regulations will defer or otherwise limit utilization of the loss on the stock in such transactions and other transactions that facilitate the group's utilization of a single loss more than once. Such regulations will apply to dispositions of stock (or another asset that reflects the basis of stock) occurring on or after March 7, 2002.

The IRS and Treasury are devoting substantial resources to the development of the regulations described in this Notice in order to issue the regulations in an expeditious manner. In addition, the IRS and Treasury are studying the various approaches that could be implemented to give full effect to § 337(d) and to reflect the single entity principles of the consolidated return rules.

REQUEST FOR PUBLIC COMMENT

Comments are requested on the scope and substance of the regulations. Direct all written comments to Internal Revenue Service, Attn: CC:ITA:RU (Notice 2002–18), room 5226, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 5:00 p.m. to: CC:ITA:RU (Notice 2002–18), Courier's desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or submitted electronically to: *Notice.Comments@irscounsel.treas.gov*. Please include "Notice 2002–18" in the subject line of your e-mail comments. All submissions will be open to public inspection.

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Civil Cause of Action for Damages Caused by Unlawful Tax Collection Actions, Including Actions Taken in Violation of Section 362 of Section 524 of the Bankruptcy Code

REG–107366–00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to civil causes of action for damages caused by unlawful collection actions of officers and employees of the IRS and the awarding of costs and certain fees. The proposed regulations reflect amendments made by the Taxpayer Bill of Rights 2 and the Internal Revenue Service Restructuring and Reform Act of 1998. The proposed regulations affect all persons who suffer damages caused by unlawful collection actions of officers or employees of the IRS.

DATES: Written comments and requests for a public hearing must be received by May 6, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–107366–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered to: CC:ITA:RU (REG–107366–00), room 5226, Internal Revenue Service, 1111 Constitution Avenue NW, Washington DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Kevin B. Connelly, (202) 622–3630 (not a toll-free number).

SUPPLEMENTAL INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to civil actions for damages caused by unlawful collection actions of officers or employees of the IRS. The Taxpayer Bill of Rights 2 (TBOR2), Public Law 104–168 (110 Stat. 1465), amended section 7433 of the Internal Revenue Code of 1986 (Code) by increasing the maximum amount of damages a taxpayer may be awarded for unlawful collection actions from $100,000 to $1,000,000. TBOR2 also eliminated the jurisdictional requirement that administrative remedies be exhausted before a court may award damages; TBOR2 authorized the court, however, to reduce damages if it determined that the plaintiff did not exhaust administrative remedies. These TBOR2 provisions were effective for actions of IRS officers or employees after July 30, 1996. The Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206 (112 Stat. 685), although retaining the pre-existing authorization for an award of damages in the case of reckless or intentional disregard of the Code or regulations, amended section 7433 by providing that taxpayers may file actions for damages caused by the negligent disregard of the Code or regulations. In addition, this amendment provided that an action for damages could be brought for the IRS's willful violation of section 362 (relating to the automatic stay) or section 524 (relating to the effect of discharge) of the Bankruptcy Code. The maximum amount of damages that may be awarded for negligent disregard is $100,000. The maximum amount of damages that may be awarded for reckless or intentional disregard or for willful violations of section 362 or 524 of the Bankruptcy Code is $1,000,000. RRA 1998 also reinstated the requirement under section 7433 that the plaintiff must exhaust administrative remedies before a court may award damages. These RRA 1998 provisions are effective for actions of IRS officers or employees after July 22, 1998.

RRA 1998 also added new subsection (h) to section 7426, which authorizes persons who bring wrongful levy actions under section 7426 to sue for damages caused by the reckless or intentional, or negligent, disregard of any provision of the Code, plus costs of the action. Consistent with section 7433, damages awarded under section 7426(h) are limited to $1,000,000 for reckless or intentional disregard and $100,000 for negligent disregard. In addition, a plaintiff must exhaust administrative remedies before a court may award damages under section 7426(h). The provisions of section 7433 relating to mitigation and the period for bringing an action also apply to actions brought under section 7426(h).

Explanation of Provisions

§ 301.7426–2

RRA 1998 added a new subsection (h) to section 7426. Subsection (h) authorizes persons to sue the United States in federal district court for damages due to a wrongful levy caused by the reckless or intentional, or negligent, disregard of a provision of the Code. Plaintiffs are entitled to recover the lesser of actual direct economic damages and costs of the action or $1,000,000 ($100,000 in the case of negligence). The amendment also provided that the rules of section 7433(d) relating to exhaustion of administrative remedies, mitigation of damages and the period for bringing an action shall apply. The proposed regulations thus adopt rules like those promulgated under section 7433 that plaintiffs must mitigate damages and no damages may be awarded unless the court determines that the plaintiff has exhausted administrative remedies available within the IRS, *e.g.*, by filing an administrative claim for damages. The proposed regulations also provide that any action for damages under this section must be brought within 2 years after the date the action accrues. This two-year limitations period is independent of the nine-month period after the wrongful levy during which the IRS may return, or the third party may make a claim for, wrongfully levied property.

§ 301.7430–8

Section 7430 provides that reasonable administrative costs may be awarded to the prevailing party in an administrative proceeding brought by or against the United States in connection with the determination, collection, or refund of any tax, interest, or penalty under Title 26. Because, prior to the amendments in RRA 1998, taxpayers generally were not entitled to recover costs for administrative proceedings in connection with collection matters, the current regulations exclude such collection matters, including proceedings under sections 7432 and 7433, from the definition of *administrative proceedings*. To reflect the RRA 1998 amendments, the proposed regulations expand the definition of an administrative proceeding to include any administrative action for damages under section 7433(e) and any procedure or action brought before the IRS seeking relief with respect to a violation by the IRS of section 362 or 524 of the Bankruptcy Code.

The proposed regulations provide that the prevailing party is a party who establishes that, in connection with the collection of his or her federal tax, the IRS has willfully violated a provision of section 362 or 524 of the Bankruptcy Code. The only administrative costs that may be awarded are those incurred after the date of the bankruptcy petition that gave rise to the section 362 stay or section 524 discharge injunction.

A claim with the IRS for administrative costs must be filed within 90 days after the date the IRS mails its decision on the taxpayer's administrative claim for damages under § 301.7433–2(e) or claim for relief from a violation of section 362 or 524 of the Bankruptcy Code.

§ 301.7433–1

Section 3102 of RRA 1998 amended section 7433(a) of the Code by providing that a taxpayer may sue the United States in a district court of the United States for damages caused by the negligent disregard of the Code or regulations in connection with the collection of the taxpayer's tax liability. Section 801 of TBOR2 amended section 7433(b) by increasing the maximum amount of damages that a taxpayer may recover for damages caused by the reckless or intentional disregard of the Code or regulations from $100,000 to $1,000,000. Section 3102 of RRA 1998 caps the amount of damages that a taxpayer may recover for negligent disregard at $100,000. The proposed regulations under § 301.7433–1 reflect these changes.

§ 301.7433–2

RRA 1998 also amended section 7433 by adding a new subsection (e). Subsection (e) gives taxpayers the right to petition the bankruptcy court to recover damages if, in connection with the collection of a federal tax, any officer or employee of the IRS willfully violates section 362 or 524 of the Bankruptcy Code or any regulation promulgated thereunder. Damages in connection with a claim under section 7433(e) are recoverable under section 7433(b) and are subject to the limitations imposed by section 7433(d).

Section 362 relates to the automatic stay, which arises by operation of law when a debtor files a bankruptcy petition. The stay prohibits certain collection actions against the debtor, the debtor's property, and the property of the bankruptcy estate. Prior to enactment of section 7433(e), individuals injured by the IRS's willful violation of the automatic stay could only sue to recover actual damages, including costs and attorneys' fees, under Bankruptcy Code section 362(h). Section 7433(e) provides an alternative cause of action to recover damages, but still permits an individual to recover damages under section 362(h) of the Bankruptcy Code, in lieu of an action under section 7433(e). However, section 7433(e) explicitly provides that administrative and litigation costs incurred in pressing a claim under section 362(h) of the Bankruptcy Code may only be paid pursuant to, and subject to the conditions described in, section 7430 of the Code. Section 7430 authorizes the payment of administrative and litigation costs only if a taxpayer exhausts administrative remedies. The proposed regulations provide that in order to qualify for an award of administrative and litigation costs in an action under section 362(h) of the Bankruptcy Code, a taxpayer must (as in the case of damages actions under section 7433(e)) file an administrative claim with the IRS relating to the violation of the automatic stay.

Section 524 sets forth the effect of a discharge under the Bankruptcy Code. A discharge operates as an injunction against the commencement or continuation of any action to collect a discharged debt as a personal liability of the debtor. Prior to enactment of section 7433(e), a debtor who believed the IRS had willfully violated the discharge injunction could request the Bankruptcy Court under Bankruptcy Code section 105 to hold the IRS in contempt and seek to recover damages under that Bankruptcy Code provision. Section 7433(e) now provides the exclusive remedy for the IRS's willful violation of the discharge injunction.

The proposed regulations set forth procedures relating to these claim and damage allowance provisions. Damages recoverable under section 7433(e) for a violation of the automatic stay or the discharge injunction are limited to (1) the actual, direct economic damages sustained by the taxpayer (and the taxpayer has a duty to mitigate those damages), plus (2) costs of the action. The maximum damage award is $1,000,000. No petition for damages under section 7433(e) may be filed in a bankruptcy court unless the taxpayer first exhausts administrative remedies within the IRS.

Similar to rules previously adopted with respect to other wrongful collection actions, the proposed regulations define direct, economic damages as actual, pecuniary damages sustained by the taxpayer as a result of the willful violation of section 362 or 524 of the Bankruptcy Code. Injuries such as inconvenience, loss of reputation, and emotional distress, are not compensable except to the extent they result in actual pecuniary loss.

The proposed regulations define costs of the action that are recoverable as damages under section 7433(e) as: (1) fees of the clerk and marshal; (2) fees of the court reporter for all or any part of the stenographic transcript necessarily obtained for use in the case; (3) fees and disbursements for printing and witnesses;

(4) fees for exemplification and copies of paper necessarily obtained for use in the case; (5) docket fees; and (6) compensation of court appointed experts and interpreters. Costs of the action do not include any costs other than those enumerated in this paragraph.

Reasonable administrative and litigation costs, including attorneys fees, are not recoverable as direct economic damages. These costs are recoverable, if at all, under section 7430. The taxpayer generally will be entitled to reasonable litigation costs under section 7430 if the taxpayer (1) files an administrative claim with the IRS, (2) establishes that the IRS willfully violated either the automatic stay under Bankruptcy Code Section 362 or the discharge injunction under section 524, (3) substantially prevails with respect to the amount of damages in controversy, and (4) meets the requirements of sections 7430(c)(4)(A)(ii) regarding net worth.

A petition for damages under section 7433 may not be filed in a bankruptcy court unless the taxpayer first files an administrative claim for damages with the IRS. The claim must be made in writing to the Chief, Local Insolvency Unit for the judicial district in which the bankruptcy was filed. The claim must include: (1) the claimant taxpayer's name, taxpayer identification number, current address, current home and work telephone numbers and any convenient times to be contacted; (2) the court and case number of the bankruptcy case in which the violation occurred; (3) a description, in reasonable detail, of the violation (with copies of any available substantiating documentation or correspondence with the IRS); (4) a description of the injuries incurred by the taxpayer filing the claim (with copies of any available substantiating documentation or evidence); (5) the dollar amount of the claim, including any damages that have not yet been incurred but which are reasonably foreseeable (along with any available substantiating documentation or evidence); and (6) the signature of the taxpayer or any duly authorized representative.

The proposed regulations provide that, after an administrative claim for damages has been filed, a petition for damages under section 7433 may not be filed in a bankruptcy court until the earlier of (1) the time a decision is rendered on the claim or (2) six months from the date the administrative claim is filed. Because a taxpayer must petition the bankruptcy court for damages within two years after the cause of action accrues, the proposed regulations contain an exception for claims filed in the last six months before the two-year limitation period expires. In those circumstances, taxpayers may file petitions for damages at any time after they file their administrative claims and before the period of limitations expires. A cause of action accrues under this section when the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action.

Special Analyses

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

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Kevin B. Connelly, Office of Associate Chief Counsel (Procedure and Administration), Collection, Bankruptcy & Summons Division, CC:PA:CBS, IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 continues to read in part as follows:

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

Par. 2. Section 301.7426–2 is added to read as follows:

§ 301.7426–2 Recovery of damages in certain cases.

(a) *In general*. In addition to remedies related to wrongful levy set forth in § 301.7426–1(b), if a district court of the United States finds in any action brought under section 7426 that any officer or employee of the Internal Revenue Service recklessly or intentionally, or by reason of negligence, disregarded any provision of this title, the United States shall be liable to the plaintiff for damages. The plaintiff has a duty to mitigate damages. The total amount of damages recoverable under this section is the lesser of $1,000,000 ($100,000 in the case of negligence), or the sum of—

(1) Actual, direct economic damages as defined in § 301.7433–1(b) sustained as a proximate result of the reckless, intentional, or negligent actions of the officer or employee, reduced by the amount of any damages awarded under § 301.7426–1(b); and

(2) Costs of the action as defined in § 301.7433–1(c).

(b) *Administrative remedies must be exhausted*. The court may not award a judgment for damages under paragraph (a) of this section unless the court determines that the plaintiff has filed an administrative claim pursuant to paragraph (d) of this section, and has satisfied the requirements of paragraph (c) of this section.

(c) *No request for damages in a district court of the United States prior to filing an administrative claim*. (1) Except as provided in paragraph (c)(2) of this section, no request for damages under paragraph (a) of this section shall be maintained in any district court of the United States before the earlier of the following dates—

(i) The date the decision is rendered on a claim filed in accordance with paragraph (d) of this section; or

(ii) The date that is six months after the date an administrative claim is filed in accordance with paragraph (d) of this section.

(2) If an administrative claim is filed in accordance with paragraph (d) of this section during the last six months of the period of limitations described in paragraph (f) of this section, the claimant may file an action in a district court of the United States any time after the administrative claim is filed and before the expiration of the period of limitations.

(d) *Procedures for an administrative claim*—(1) *Manner*. An administrative claim for the lesser of $1,000,000 ($100,000 in the case of negligence) or actual, direct economic damages as defined in § 301.7433–1(b) shall be sent in writing to the Chief, Local Insolvency Unit for the area in which the levy was made.

(2) *Form*. The administrative claim shall include—

(i) The name, taxpayer identification number, current address and current home and work telephone numbers (indicating any convenient times to be contacted) of the person making the claim;

(ii) The grounds, in reasonable detail, for the claim (include copies of any available substantiating documentation or correspondence with the Internal Revenue Service);

(iii) A description of the damages incurred by the claimant filing the claim (include copies of any available substantiating documentation or evidence);

(iv) The dollar amount of the claim, including any damages that have not yet been incurred but which are reasonably foreseeable (include copies of any available substantiating documentation or evidence); and

(v) The signature of the claimant or duly authorized representative.

(3) *Duly authorized representative*. For purposes of this paragraph (d), a duly authorized representative is any attorney, certified public accountant, enrolled actuary, or any other person permitted to represent the claimant before the Internal Revenue Service who is not disbarred or suspended from practice before the Internal Revenue Service and who has a written power of attorney executed to the claimant.

(e) *No liability for damages for any sum in excess of the dollar amount sought in the administrative claim*. See § 301.7433–1(f).

(f) *Period of limitations*—(1) *Time for filing*. A civil action under paragraph (a) of this section must be brought in a district court of the United States within 2 years after the date the cause of action accrues.

(2) *Right of action accrues*. A cause of action under paragraph (a) of this section accrues when the plaintiff has had a reasonable opportunity to discover all essential elements of a possible cause of action.

(g) *Recovery of costs under section 7430*. See § 301.7433–1(h).

(h) *Effective date*. This section is applicable on the date final regulations are published in the **Federal Register**.

Par. 3. Section 301.7430–1 is amended by redesignating paragraphs (e), (f), and (g) as paragraphs (f), (g), and (h), respectively, and adding a new paragraph (e) to read as follows:

§ 301.7430–1 Exhaustion of administrative remedies.

* * * * *

(e) *Actions involving willful violations of the automatic stay under section 362 of the Bankruptcy Code*—(1) *Section 7433 claims*. A party has not exhausted administrative remedies within the Internal Revenue Service with respect to asserted violations of the automatic stay under section 362 of the Bankruptcy Code or the discharge provisions under section 524 of the Bankruptcy Code unless it files an administrative claim for damages or for relief from a violation of section 362 or 524 of the Bankruptcy Code with the Chief, Local Insolvency Unit, for the area in which the bankruptcy petition that is the basis for the asserted automatic stay was filed pursuant to § 301.7433–2(e) and satisfies the other conditions set forth in § 301.7433–2(d) prior to filing a petition under section 7433.

(2) *Section 362(h) claims*. A party has not exhausted administrative remedies within the Internal Revenue Service with respect to asserted violations of the automatic stay under section 362 of the Bankruptcy Code unless it files an administrative claim for relief from a violation of section 362 of the Bankruptcy Code with the Chief, Local Insolvency Unit, for the area in which the bankruptcy petition that is the basis for the asserted automatic stay was filed pursuant to § 301.7433–2(e) and satisfies the other conditions set forth in § 301.7433–2(d) prior to filing a petition under section 362(h) of the Bankruptcy Code.

* * * * *

§ 301.7430–2 [Amended]

Par. 4. In § 301.7430–2, paragraph (c)(2) is amended by:

1. Adding the language "except that requests with respect to administrative proceedings defined by § 301.7430–8(c) should be made to the Chief, Local Insolvency Unit" at the end of the first sentence.

2. Removing the language "District Director for the district" and adding "Internal Revenue Service office" in its place in the second sentence.

Par. 5. Section 301.7430–3 is amended by:

1. Revising paragraph (a)(4),

2. Paragraph (b) is amended by adding the language "except those collection actions described by section 7433(e)" at the end of the last sentence.

The revision reads as follows:

§ 301.7430–3 Administrative proceeding and administrative proceeding date.

(a) * * *

(4) Proceedings in connection with collection actions (as defined in paragraph (b) of this section), including proceedings under section 7432 or 7433, except proceedings brought under section 7433(e) and § 301.7433–2 or proceedings otherwise described in § 301.7430–8(c). See § 301.7430–8.

* * * * *

Par. 6. Section 301.7430–6 is amended by adding a sentence at the end of the section to read as follows:

§ 301.7430–6 Effective dates.

* * * Sections 301.7430–2(c)(2), 7430–3(a)(4) and (b) are applicable with respect to actions taken by the Internal Revenue Service after July 22, 1998.

Par. 7. Section 301.7430–8 is added to read as follows:

§ 301.7430–8 Administrative costs incurred in damage actions for violations of sections 362 and 524 of the Bankruptcy Code.

(a) *In general*. The Internal Revenue Service may grant a taxpayer's request for recovery of reasonable administrative costs incurred in connection with the administrative proceeding before the Internal Revenue Service relating to the willful violation of section 362 or 524 of the Bankruptcy Code only if the taxpayer is a prevailing party.

(b) *Prevailing party*. A taxpayer is a prevailing party for purposes of this section only if—

(1) The taxpayer satisfies the net worth and size limitations in paragraph (f) of § 301.7430–5;

(2) The taxpayer establishes that in connection with the collection of his or her federal tax an officer or employee of the Internal Revenue Service has willfully violated a provision of section 362 or 524 of the Bankruptcy Code; and

(3) The position of the Internal Revenue Service in the proceeding was not substantially justified.

(c) *Administrative proceeding*. For purposes of this section, an administrative proceeding is a proceeding related to an administrative claim presented to the Internal Revenue Service seeking relief from a violation of section 362 or 524 of the Bankruptcy Code by the Internal Revenue Service or recovery of damages from the Internal Revenue Service under § 301.7433–2(e).

(d) *Costs incurred after filing of bankruptcy petition*. Administrative costs may be recovered only if incurred on or after the date of filing of the bankruptcy petition that formed the basis for the stay on collection under Bankruptcy Code section 362 or the discharge injunction under Bankruptcy Code section 524, as the case might be.

(e) *Time for filing claim for administrative costs*. (1) For purposes of this section, the taxpayer must file a claim for administrative costs before the Internal Revenue Service not later than 90 days after the date the Internal Revenue Service mails to the taxpayer, or otherwise notifies the taxpayer of, the decision regarding the claim for relief from or damages relating to a violation of the collection stay or the discharge injunction to the taxpayer.

(2) If the Internal Revenue Service denies the claim for administrative costs in whole or in part, the taxpayer must file a petition with the Bankruptcy Court for administrative costs no later than 90 days after the date on which the denial of the claim for administrative costs is mailed, or otherwise furnished, to the taxpayer. If the Internal Revenue Service does not respond on the merits to a request by the taxpayer for an award of reasonable administrative costs within 6 months after such request is filed, the Internal Revenue Service's failure to respond may be considered by the taxpayer as a denial of an award of reasonable administrative costs.

(3) For purposes of paragraphs (e)(1) and (2) of this section, if the 90th day falls on a Saturday, Sunday, or a legal holiday, the 90-day period shall end on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. The term legal holiday means a legal holiday in the District of Columbia. If the request for costs is to be filed with the Internal Revenue Service at an office of the Internal Revenue Service located outside the District of Columbia but within an internal revenue district, the term legal holiday also means a statewide legal holiday in the state where such office is located.

(f) *Effective date*. This section is applicable with respect to actions taken by the Internal Revenue Service after July 22, 1998.

Par. 8. Section 301.7433–1 is amended as follows:

1. In paragraph (a) introductory text, in the first sentence, the language ", or by reason of negligence," is added after the language "recklessly or intentionally". In addition, the language "$100,000" in the third sentence is removed and "$1,000,000 ($100,000 in the case of negligence)" is added in its place.

2. In paragraph (b)(1) the language ", or negligent," is added after the language "reckless or intentional".

3. In paragraph (e)(1), in the first sentence, the language "$100,000" is removed and "$1,000,000 ($100,000 in the case of negligence)" is added in its place. In addition, the language "district director (marked for the attention of the Chief, Special Procedures Function) of the district" is removed and "Chief, Local Insolvency Unit in the area" is added in its place.

4. In paragraph (h), in the penultimate sentence, the language "7432(a)" is removed and "7433(a)" is added in its place.

5. Revising paragraph (i).

The revision reads as follows:

§ 301.7433–1 Civil cause of action for certain unauthorized collection actions.

* * * * *

(i) *Effective dates*. The portions of this section relating to reckless or intentional acts are applicable to actions taken by Internal Revenue Service officials after July 30, 1996. The portions of this section relating to negligent acts are applicable to actions taken by the Internal Revenue Service officials after July 22, 1998.

Par. 9. Section 301.7433–2 is added to read as follows:

§ 301.7433–2 Civil cause of action for violation of section 362 or 524 of the Bankruptcy Code.

(a) *In general*. (1) If, in connection with the collection of a federal tax with respect to a taxpayer, an officer or employee of the Internal Revenue Service willfully violates any provision of section 362 (relating to the automatic stay) or section 524 (relating to discharge) of title 11, United States Code, or any regulation promulgated under the provisions of title 11, United States Code, the taxpayer may file a petition for damages against the United States in federal bankruptcy court. The taxpayer has a duty to mitigate damages. The total amount of damages recoverable under this section is the lesser of $1,000,000, or the sum of—

(i) Actual, direct economic damages sustained as a proximate result of the willful actions of the officer or employee; and

(ii) Costs of the action.

(2) An action under this section constitutes the exclusive remedy under the Internal Revenue Code for violations of sections 362 and 524 of the Bankruptcy Code. In addition, taxpayers injured by violations of section 362 of the Bankruptcy Code may maintain actions under section 362(h) of the Bankruptcy Code (relating to an individual injured by a willful violation of the stay).

(b) *Actual, direct economic damages*—(1) *Definition*. See § 301.7433–1(b)(1).

(2) *Litigation costs and administrative costs not recoverable as actual, direct economic damages*. Litigation costs and administrative costs are not recoverable as actual, direct economic damages. These costs may be recoverable under section 7430 (see paragraph (h) of this section), or, solely to the extent described in paragraph (c) of this section, as costs of the action.

(c) *Costs of the action*. Costs of the action recoverable as damages under this section are limited to the costs set forth in § 301.7433–1(c).

(d) *No civil action in federal bankruptcy court prior to filing an administrative claim*—(1) *In general*. Except as provided in paragraph (d)(2) of this section, no action under paragraph (a)(1) of this section shall be maintained in any bankruptcy court before the earlier of the following dates—

(i) The date the decision is rendered on a claim filed in accordance with paragraph (e) of this section; or

(ii) The date that is six months after the date an administrative claim is filed in accordance with paragraph (e) of this section.

(2) *When administrative claim filed in last six months of period of limitations*. If an administrative claim is filed in accordance with paragraph (e) of this section during the last six months of the period of limitations described in paragraph (g) of this section, the taxpayer may petition the bankruptcy court any time after the administrative claim is filed and before the expiration of the period of limitations.

(e) *Procedures for an administrative claim*—(1) *Manner*. An administrative claim for the lesser of $1,000,000 or actual, direct economic damages as defined in paragraph (b) of this section shall be sent in writing to the Chief, Local Insolvency Unit, for the judicial district in which the taxpayer filed the underlying bankruptcy case giving rise to the alleged violation.

(2) *Form*. The administrative claim shall include—

(i) The name, taxpayer identification number, current address, and current home and work telephone numbers (with an identification of any convenient times to be contacted) of the taxpayer making the claim;

(ii) The location of the bankruptcy court in which the underlying bankruptcy case was filed and the case number of the case in which the violation occurred;

(iii) A description, in reasonable detail, of the violation (include copies of any available substantiating documentation or correspondence with the Internal Revenue Service);

(iv) A description of the injuries incurred by the taxpayer filing the claim (include copies of any available substantiating documentation or evidence);

(v) The dollar amount of the claim, including any damages that have not yet been incurred but which are reasonably foreseeable (include copies of any available documentation or evidence); and

(vi) The signature of the taxpayer or duly authorized representative.

(3) *Duly authorized representative defined*. For purposes of this paragraph (e), a duly authorized representative is any attorney, certified public accountant, enrolled actuary, or any other person permitted to represent the taxpayer before the Internal Revenue Service who is not disbarred or suspended from practice before the Internal Revenue Service and who has a written power of attorney executed by the taxpayer.

(f) *No action in bankruptcy court for any sum in excess of the dollar amount sought in the administrative claim*. No action for actual, direct economic damages under paragraph (a) of this section may be instituted in federal bankruptcy court for any sum in excess of the amount (already incurred and estimated) of the administrative claim filed under paragraph (e) of this section, except where the increased amount is based upon newly discovered evidence not reasonably discoverable at the time the administrative claim was filed, or upon allegation and proof of intervening facts relating to the amount of the claim.

(g) *Period of limitations*—(1) *Time for filing*. A petition for damages under paragraph (a) of this section must be filed in bankruptcy court within two years after the date the cause of action accrues.

(2) *Right of action accrues*. A cause of action under paragraph (a) of this section accrues when the taxpayer has had a reasonable opportunity to discover all essential elements of a possible cause of action.

(h) *Recovery of litigation costs and administrative costs under section 7430*—(1) *In general*. Litigation costs, as defined in § 301.7433–1(b)(2)(i), including attorneys fees, not recoverable under this section may be recoverable under section 7430 if a taxpayer challenges in whole or in part an Internal Revenue Service denial of an administrative claim for damages by filing a petition in the bankruptcy court. If, following the Internal Revenue Service's denial of an administrative claim for damages, a taxpayer files a petition in the bankruptcy court challenging that denial in whole or in part, substantially prevails with respect to the amount of damages in controversy, and meets the requirements of section 7430(c)(4)(A)(ii) (relating to net worth and size requirements), the taxpayer will be considered a prevailing party for purposes of section 7430, unless the Internal

Revenue Service establishes that the position of the Internal Revenue Service in the proceeding was substantially justified. Such taxpayer will generally be entitled to attorneys' fees and other reasonable litigation costs not recoverable under this section. For purposes of this paragraph (h), if the Internal Revenue Service does not respond on the merits to an administrative claim for damages within six months after the claim is filed, the Internal Revenue Service's failure to respond will be considered a denial of the claim on the grounds that the Internal Revenue Service did not willfully violate Bankruptcy Code section 362 or 524.

(2) *Administrative costs*—(i) *In general*. Administrative costs, as defined in § 301.7433–1(b)(2)(ii), including attorneys' fees, not recoverable under this section may be recoverable under section 7430. See § 301.7430–8.

(ii) *Limitation regarding recoverable administrative costs*. Administrative costs may be awarded only if incurred on or after the date of filing of the bankruptcy petition that formed the basis for the stay on collection under Bankruptcy Code section 362 or the discharge injunction under Bankruptcy Code section 524, as the case might be.

(i) *Effective date*. This section is applicable to actions taken by the Internal Revenue Service officials after July 22, 1998.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 5, 2002, 8:45 a.m., and published in the issue of the Federal Register for March 6, 2002, 67 F.R. 9929)

Notice of Proposed Rulemaking and Notice of Public Hearing

Application of Section 338 to Insurance Companies

REG–118861–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations that apply to a deemed sale or acquisition of an insurance company's assets pursuant to an election under section 338 of the Internal Revenue Code, to a sale or acquisition of an insurance trade or business subject to section 1060, and to the acquisition of insurance contracts through assumption reinsurance. It also contains proposed regulations under section 381 concerning the effect of certain corporate liquidations and reorganizations on certain tax attributes of insurance companies. The proposed regulations apply to insurance companies and to corporations selling and purchasing stock of insurance companies. This document also provides a notice of public hearing on the proposed regulations.

DATES: Written or electronic comments and requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for September 18, 2002, must be received by August 28, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG–118861–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8:00 a.m. and 5:00 p.m. to CC:ITA:RU (REG–118861–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20044. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at *www.irs.gov/regs*. The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Gary Geisler, (202) 622–3970, or Mark Weiss, (202) 622–7790, concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy Traynor, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Overview of the Proposed Regulations

These proposed regulations apply to taxable asset acquisitions and dispositions of insurance businesses and companies, many of which occur by virtue of elections under section 338 of the Internal Revenue Code (Code). A number of questions have arisen concerning the tax consequences of such transactions, and numerous requests for clarification were received in response to the proposal of regulations under sections 338 and 1060 (REG–107069–97, 1999–2 C.B. 346 [64 FR 43462]) in 1999. The Treasury decision finalizing those regulations in February, 2001, announced the intention of the IRS and Treasury to provide guidance regarding the treatment of a deemed asset sale by an insurance company in a separate project (T.D. 8940, 2001–15 I.R.B. 1016, 1017 [66 FR 9925]). That additional guidance is proposed in this document.

In taxable asset acquisitions governed by section 338 or 1060 generally, the total cost of the acquisition is apportioned among specific assets under a residual method that extrapolates the price of each asset from the overall price of the transaction (including assumed liabilities), ranking the assets in classes for priority of allocation, with goodwill and going concern value (Class VII assets) ranked last and section 197 intangibles (Class VI assets) ranked next to last. See §§ 1.338–6(b)(2) and 1.1060–1(a)(1). Rights under an insurance company's outstanding insurance contracts (commonly known as insurance in force) that are acquired through assumption reinsurance as part of a taxable asset acquisition generally are intangible assets that constitute section 197 intangibles within the meaning of section 197(d) and, hence, are classified as Class VI assets under § 1.338–6(b)(2)(vi).

The term *assumption reinsurance* refers to an arrangement whereby the reinsurer, or buyer, becomes solely liable to the policyholders on contracts transferred by the ceding company, or seller, who ceases to have any liability under the transferred contracts. See § 1.809–5(a)(7)(ii); see also *Colonial American*

Life Ins. Co. v. Commissioner, 491 U.S. 244, 247 (1989); *Beneficial Life Ins. Co. v. Commissioner*, 79 T.C. 627, 636 (1982). It has historically been the IRS's position that, where insurance contracts are acquired from an insurance company as part of a taxable asset acquisition, the transfer of contract rights and assumption of related liabilities is treated as an assumption reinsurance transaction if the ceding company ceases to be liable to the policyholders. See *Southwestern Life Ins. Co. v. Commissioner*, 560 F.2d 627 (5th Cir. 1977), *cert. denied*, 435 U.S. 995 (1978); see also H.R. Rep. No. 103–213, 103d Cong., 1st Sess. 687 n.25 (1993); § 1.338–1(a)(2).

Section 1.817–4(d) prescribes rules for the income tax treatment of assumption reinsurance transactions entered into by life insurance companies in the ordinary course of business. Under § 1.817–4(d)(2)(ii) and (iii), the reinsurer is treated as receiving premium income from the reinsured in an amount equal to at least the increase in the reinsurer's reserves resulting from the transaction, and the reinsurer is entitled to deduct the increase in its reserves that is attributable to the acquisition of the insurance contracts. If the reinsurer receives an amount less than the amount of such reserves, the difference is treated as the amount paid by the reinsurer for the purchase of the reinsured contracts (*i.e.*, the ceding commission). The reinsurer must capitalize the ceding commission as an item of deferred expense. Thus, the reinsurer's deduction for its increase in reserves resulting from the assumption reinsurance transaction offsets premium income, and the reinsurer is treated as purchasing intangible assets (*i.e.*, insurance contracts) to the extent that the net consideration received by the reinsurer is less than its increase in reserves. If the actual amount received by the reinsurer exceeds the increase in the reinsurer's reserves resulting from the transaction, the entire amount received by the reinsured is treated as premium income, and the reinsurer is not treated as having paid any amount for the purchase of the reinsured contracts (*i.e.*, the economics of the transaction indicate that the insurance contracts have no positive value).

Under § 1.817–4(d), the ceding company treats the gross amount paid to the reinsurer, reduced by any payment received from the reinsurer, as an item of deduction for consideration paid for reinsurance. See § 1.817–4(d)(2)(i). This deduction fully or partially offsets the amount included in the gross income of the ceding company that is attributable to the decrease in the ceding company's reserves as a result of the reinsurance transaction. Because the amount of the deduction is reduced by the amount that the reinsurer actually or implicitly pays to purchase the contracts, the net effect is to treat any amount received by the ceding company for the sale of the reinsured contracts as ordinary income.

Although § 1.817–4(d) applies only to assumption reinsurance transactions involving life insurance companies, the general structure of the regulations is not based on any statutory provisions unique to life insurance companies. Moreover, because these rules are an application of general principles of insurance taxation, many should apply not only to assumption reinsurance transactions, but also to indemnity reinsurance transactions, where the ceding company is not fully relieved of the policy risks.

The proposed regulations generally treat the transfer of an insurance or annuity contract or group of such contracts (hereinafter insurance contracts) and the assumption of related reserve liabilities that are deemed to occur by reason of an election under section 338 in a manner consistent with the treatment of ordinary assumption reinsurance transactions under § 1.817–4(d) and other provisions of subchapter L of chapter 1, subtitle A of the Code and the regulations promulgated thereunder. The proposed regulations provide similar rules for acquisitions of insurance businesses governed by section 1060, whether effected through assumption or indemnity reinsurance. Thus, in the case of both a deemed and an actual transfer of an insurance business, the reinsurer (in the case of a section 338 election, new target) is treated as receiving premium income for its assumption of reserve liabilities and having an offsetting deduction for its increase in reserves, and the ceding company (in the case of a section 338 election, old target) is treated as having income in the amount of the reduction in its reserves and having a deduction for the premium it pays for the reinsurer's assumption of those liabilities. Moreover, consistent with § 1.817–4(d), the consideration allocated to the value of the insurance contracts acquired in the assumption reinsurance transaction is treated as an amount paid by the reinsurer to purchase intangible assets and as ordinary income to the ceding company.

However, section 1.817–4(d) does not fully describe the income tax treatment of insurance contracts that are transferred and the related reserve liabilities that are assumed as part of the acquisition of an entire company or trade or business. In particular, § 1.817–4(d) addresses transactions in which the consideration paid for the transfer of insurance contracts and assumption of related liabilities is known and not part of a larger acquisitive transaction. Therefore, in order to give effect to the principles and rules governing taxable asset acquisitions for all trades or businesses generally, these proposed regulations depart in certain respects from the rules governing assumption reinsurance transactions effected in the ordinary course of business. The key elements of the proposed regulations are as follows:

1. In general, the seller's tax reserves are treated in the same manner as fixed liabilities that have been taken into account for Federal income tax purposes and, thus, the seller's closing tax reserves are treated as a liability in the computation of the seller's aggregate deemed sales price (ADSP) and the buyer's adjusted grossed-up basis (AGUB).

2. The residual method that otherwise applies to transactions governed by sections 338 and 1060 applies to allocate the ADSP and AGUB among classes of transferred assets, including insurance contracts, which constitute Class VI assets (regardless of whether they are section 197 intangibles). Thus, the amount of consideration allocated to insurance contracts under the residual method is treated as the amount paid by the buyer for the purchase of insurance contracts in the assumption reinsurance transaction (*i.e.*, as a ceding commission to the seller).

3. The gross amount of the reinsurance premium paid by the seller to the

buyer is deemed to equal the seller's closing tax reserves in all cases, thereby eliminating the possibility of immediate net taxable income to the buyer.

Computation and Allocation of AGUB and ADSP

In accordance with the principles set forth above, these proposed regulations provide rules regarding the computation and allocation of AGUB and ADSP where the target is an insurance company. See proposed § 1.338–11(a) through (c). A special rule provides that, for purposes of allocating AGUB and ADSP under the residual method, the fair market value of insurance contracts is the amount a willing reinsurer would pay a willing ceding company in an arm's length transaction as a ceding commission for the reinsurance of the specific insurance contracts if the gross reinsurance premium for the insurance contracts were equal to old target's tax reserves for the insurance contracts. See proposed § 1.338–11(b)(2).

Rules comparable to the proposed rules governing the computation and allocation of AGUB and ADSP are proposed to apply to applicable asset acquisitions under section 1060. See proposed § 1.1060–1(c)(5). To insure that these rules apply only to acquisitions of insurance businesses and not to ordinary reinsurance transactions, the proposed regulations describe when an acquisition of insurance contracts will be treated as an applicable asset acquisition. The proposed regulations provide that the mere reinsurance of insurance contracts by an insurance company is not an applicable asset acquisition, even if it enables the reinsurer to establish a customer relationship with the owners of the reinsured contracts. However, the transfer of an insurance business is an applicable asset acquisition if the purchaser acquires significant business assets, in addition to insurance contracts, to which goodwill and going concern value could attach. See proposed § 1.1060–1(b)(9).

Treatment of Liabilities

For purposes of computing ADSP and AGUB, the proposed regulations treat old target's closing tax reserves (before giving effect to the deemed sale and assumption reinsurance transaction) as a liability. See proposed § 1.338–11(b)(1). The IRS and Treasury recognize that in the context of acquisitions of businesses other than insurance businesses, courts have held that when contingent liabilities assumed in connection with an asset acquisition mature, such liabilities, like fixed liabilities, must be capitalized as a cost of the acquired assets, even if those matured liabilities would have been currently deductible had they been incurred in the acquirer's own historic business. See *Pacific Transport Co. v. Commissioner*, 483 F.2d 209, 214 (9th Cir. 1973), *cert. denied*, 415 U.S. 948 (1974); *Illinois Tool Works Inc. v. Commissioner*, 117 T.C. No. 4 (July 31, 2001). As a theoretical matter, in the context of acquisitions of insurance businesses, capitalization could be required, and deductions could be disallowed, for all post-acquisition increases in reserves that are attributable to liabilities under acquired insurance contracts that were contingent at the time of the acquisition.

For a number of reasons, however, the IRS and Treasury believe that it would be inappropriate to require capitalization of all such post-acquisition increases in an insurance company's assumed reserve liabilities. First, to the extent that reserves are discounted and post-acquisition increases are attributable to increases in the present value of assumed liabilities reflected in the acquisition date reserves, such increases are more properly treated as a currently deductible business expense of the reinsurer, analogous to interest on a fixed liability, rather than as a capital cost of the acquired assets. Second, to the extent that insurance reserves represent estimates of contingent liabilities under insurance contracts, the IRS and Treasury recognize that adjustments to these estimates are customary and that, unlike adjustments in other businesses, such adjustments may either increase or decrease an insurance company's taxable income. Thus, it would be impractical and inappropriate to treat all such adjustments as adjustments to the cost of acquired assets. No inference, however, is intended regarding the tax treatment of contingent liabilities in situations not covered by these proposed regulations.

Although the IRS and Treasury believe that certain increases in reserves that are attributable to acquired insurance contracts should be currently deductible, the IRS and Treasury believe that post-acquisition reserve increases should be capitalized in certain situations where it becomes clear that the ceding company's tax reserves as of the acquisition date were understated. In such cases, increasing the tax reserves attributable to the acquired insurance contracts after the acquisition should not produce a more favorable result for the reinsurer than had the ceding company increased such reserves before the acquisition. Accordingly, proposed § 1.338–11(d) provides for the capitalization by the reinsurer of certain reserve increases in the four taxable years after the acquisition date.

Tax reserve increases from three sources with respect to acquired contracts could potentially be subject to capitalization under these proposed regulations: increases of unpaid loss reserves attributable to changes in loss estimates, increases of other reserves through changes in methodology or assumptions, and increases of unpaid loss reserves as a result of reinsuring acquired contracts at a loss. See proposed § 1.338–11(d)(3) and (d)(4). In particular, the proposed regulations require capitalization of unpaid loss reserve increases in excess of cumulative annual increases of two percent from the acquisition date reserves for unpaid losses attributable to acquired insurance contracts and for acquired contracts transferred through reinsurance transactions. Capitalization is not required, however, to the extent increases to reserves for unpaid losses attributable to acquired insurance contracts reflect the time value of money. In addition, the reinsurer is not required to capitalize any post-acquisition reserve increases to the extent such increases occur while it is under state receivership or to the extent the deduction for the reserve increase is spread over the 10 succeeding taxable years pursuant to section 807(f). See proposed § 1.338–11(d)(2).

To the extent a reinsurer is required to capitalize reserve increases, the reinsurer must include such amount in gross income in the year of the increase to offset the deduction taken under section 832(b)(5) for the reserve increases. The reinsurer must include the amount to be capitalized in AGUB and treat such amount as additional premium received in the deemed asset sale as of the year of the adjustment. See proposed § 1.338–11(d)(1). The ceding company does not make any adjustments under this provision. See proposed § 1.338–11(d)(1).

Other Issues

In addition to providing guidance regarding the treatment of the deemed asset sale under section 338 and the assumption reinsurance transaction that is deemed to occur in connection therewith, the proposed regulations provide guidance on several other issues that arise in the context of these transactions. In general, these other rules also apply to insurance companies that sell an insurance business in a transaction governed by section 1060 if the sale occurs in connection with the complete liquidation of the ceding company. See proposed § 1.1060–1(c)(5). The rules in the proposed regulations under section 197 also apply to reinsurers of insurance businesses in transactions governed by section 1060 if effected through assumption reinsurance.

Amortization Under Section 197

These regulations propose amendments to the regulations under section 197 to provide guidance concerning the treatment under section 197 of insurance contracts acquired through assumption reinsurance transactions. For purposes of this section, the term *insurance contracts* includes an annuity contract or group of annuity contracts. See proposed § 1.197–2(g)(5).

Section 197(f)(5) provides that, in the case of any amortizable section 197 intangible resulting from an assumption reinsurance transaction, the amount taken into account as the adjusted basis of such intangible under section 197 is the excess of (A) the amount paid or incurred by the acquirer in the assumption reinsurance transaction, over (B) the amount required to be capitalized under section 848 in connection with the transaction. For policy related intangibles acquired in an assumption reinsurance transaction, section 197(f)(5) determines the amount that must be capitalized and amortized under section 197 and the portion that may be expensed because it is reflected in the reinsurer's capitalization of specified policy acquisition expenses under section 848.

The current regulations under section 197 reserve the interpretation of section 197(f)(5) in the context of stock acquisitions with respect to which an election under section 338 is made. See § 1.197–2(g)(5)(ii)(C). For other assumption reinsurance transactions, § 1.197–2(g)(5)(ii)(A) interprets the amount paid or incurred as the amount determined under § 1.817–4(d)(2) and the amount required to be capitalized under section 848 as the amount of the specified policy acquisition expenses that are attributable to the reinsurer's net positive consideration for the reinsurance agreement (as determined under § 1.848–2(f)(3)).

The proposed regulations clarify that section 197(f)(5) determines the basis of an amortizable section 197 intangible asset with respect to insurance contracts acquired in an assumption reinsurance transaction. See proposed § 1.197–2(g)(5)(i)(A). Under these proposed regulations, the amount paid or incurred to acquire the relevant insurance contracts is, in a transaction governed by section 338 or 1060, the amount of the AGUB or consideration allocable to the insurance contracts under the residual method. For this purpose, the insurance contracts are valued by assuming a gross premium equal to the tax reserves. For transactions not governed by section 338 or 1060, the amount paid or incurred for insurance contracts is the excess of the increase in the reinsurer's tax reserves resulting from the transaction (computed in accordance with sections 807, 832(b)(4)(B), and 846) over the value of the net assets received from the ceding company in the transaction. See proposed § 1.197–2(g)(5)(i)(C).

Proposed § 1.197–2(g)(5)(i)(D) provides guidance concerning the amount required to be capitalized under section 848 in connection with an assumption reinsurance transaction. Section 848 requires an insurance company to capitalize annually an amount of its "general deductions" as "specified policy acquisition expenses" (DAC). Each year, an insurance company capitalizes its general deductions (amounts otherwise deductible under sections 161 *et seq.* and 401 *et seq.*) up to the percentage set forth in section 848(c) of the amount by which premiums received on specified insurance contracts in the taxable year exceeds return premiums and premiums paid for reinsurance (net premiums). The assumption reinsurance transaction itself typically generates no general deductions for the reinsurer. Accordingly, the amount to be capitalized must be determined by reference to the reinsurer's other general expenses and the effect of the transaction on the reinsurer's net premiums. The IRS and Treasury believe that, for purposes of section 197(f)(5)(B), the amount required to be capitalized under section 848 in connection with the transaction should take into account the ceding company's actual DAC capitalization amount, based on its general deductions for the year and its net premiums for the year, including premiums received in the assumption reinsurance transaction.

Under the proposed regulations, the computation of the amount described in section 197(f)(5)(B) is based on the actual capitalization amount and is determined at the end of the year by multiplying the DAC for the taxable year by a fraction, the numerator of which is the tentative positive capitalization amount for the relevant group of acquired insurance contracts and the denominator of which is the total tentative positive capitalization amount for the taxable year with regard to all specified insurance contracts. The tentative positive capitalization amount for the acquired insurance contracts is the net positive consideration received for the insurance contracts in the assumption reinsurance transaction multiplied by the percentage factor applicable to the insurance contracts under section 848(c). The total tentative positive capitalization amount for the taxable year is the sum of each year's net premiums (in each category) multiplied by its applicable percentage factor. The total amount required to be capitalized under section 197(f)(5)(B) cannot be less than zero or greater than the amount of the DAC for the year.

The amortization of intangibles under section 197 is a general deduction relevant in computing DAC. The amount of amortization, however, cannot be calculated until section 197(f)(5) is applied to compute the year's DAC. To avoid complex calculations, the proposed regulations assume that, for purposes of calculating the basis for amortization, one-half of the consideration allocated to the insurance contracts is amortizable under section 197. Comments are requested regarding alternative approaches to calculating the basis for DAC and section 197 amortization.

Losses on Dispositions of Acquired Insurance Contracts

In general, gain or loss is recognized on a disposition, including a retirement, of an asset. Section 197(f)(1)(A), however, overrides this general rule and bars the recognition of any loss on the disposition of an amortizable section 197 intangible acquired in a transaction if the taxpayer retains one or more other amortizable section 197 intangibles acquired in the same transaction. Where such a loss is denied, the adjusted bases of the retained intangibles are increased to account for the amount of the unrecognized loss. Section 1.197–2(g)(2)(B) provides that the abandonment of an amortizable section 197 intangible, or any other event rendering an amortizable section 197 intangible worthless, is treated as a disposition for purposes of the loss disallowance rule of section 197(f)(1)(A).

The regulations under section 197, however, do not provide any special guidance on the ability of a taxpayer to recover basis or the proper method for computing loss on the disposition of an amortizable section 197 intangible relating to insurance contracts. Such guidance is necessary because, in contrast to dispositions of other intangibles, subchapter L generally does not compute an "amount realized" on the disposition of insurance contracts. Accordingly, the proposed regulations provide such guidance.

Under the proposed regulations, a disposition of a section 197(f)(5) intangible is any event as a result of which, absent section 197, recovery of basis is otherwise allowed for Federal income tax purposes. See proposed § 1.197–2(g)(5)(ii)(A). The proposed regulations provide specific guidance regarding when recovery of basis is allowed with respect to a section 197(f)(5) intangible in the context of an indemnity reinsurance transaction. In particular, they provide that basis recovery is permitted when sufficient economic rights related to the insurance contracts that gave rise to such intangible have been transferred. Sufficient economic rights are treated as transferred when the ceding company transfers the right to future income on insurance contracts. Sufficient economic rights, however, are not treated as transferred if an experience refund provision, a recapture option, or another mechanism enables the taxpayer to retain a right to a substantial portion of the future profits on the reinsured policies. In addition, sufficient economic rights are not treated as transferred if the reinsurer assumes only a limited portion of the ceding company's risk relating to the underlying reinsured contracts (*e.g.*, excess loss reinsurance).

The proposed regulations also provide rules governing the amount of loss recognized on the disposition of a section 197(f)(5) intangible. Such loss equals the amount, if any, by which the adjusted basis of the section 197(f)(5) intangible immediately prior to the disposition exceeds the amount, if any, that the taxpayer receives from another person for the right to future income on the insurance contracts to which the section 197(f)(5) intangible relates. See proposed § 1.197–2(g)(5)(ii)(A)(2). The proposed regulations also provide that, in determining the amount of the taxpayer's loss on the disposition of a section 197(f)(5) intangible through a reinsurance transaction, any effect of the transaction on the amounts capitalized by the taxpayer as DAC is disregarded. See proposed § 1.197–2(g)(5)(ii)(B).

Other than in the case of certain reinsurance transactions, the proposed regulations do not provide specific guidance regarding when a disposition of a section 197(f)(5) intangible occurs or the extent to which a taxpayer should be permitted to recover the adjusted basis of a section 197(f)(5) intangible. Comments are requested regarding whether additional guidance should address other situations or issues.

Capitalization Under Section 848

DAC amounts are intended to serve as a proxy for an insurance company's actual cost of acquiring insurance contracts. An insurance company's DAC for a particular year will be negative (negative DAC) if return premiums and premiums paid for reinsurance for the year exceed premiums received in that year. Insurance companies are permitted to use any negative DAC to deduct currently the unamortized balance of DAC capitalized in prior years. Any remaining negative DAC can be carried forward to offset the DAC attributable to premiums received in future years.

Under proposed § 1.338–11(e), the assumption reinsurance transaction that results from section 338 generally has the same effect under section 848 as other assumption reinsurance transactions. That is, the assumption reinsurance transaction first reduces the current year's capitalization requirement and then offsets any unamortized DAC capitalized in prior years, which results in a current expense deduction.

The IRS and Treasury believe that, generally, once the ceding company no longer conducts an insurance business and ceases to exist for Federal income tax purposes, any relief from capitalization it might have enjoyed going forward is not appropriately transferred to a taxpayer other than a successor insurance company under section 381. Because regulations under § 1.381(c)(22)–1(b) have not been previously amended to reflect the enactment of section 848, the proposed regulations provide that remaining balances of DAC or excess negative DAC carry over to a successor insurance company in a section 381 transaction. See proposed § 1.381(c)(22)–1(b)(13). In all other cases, these proposed regulations provide that if, after giving effect to the reinsurance transaction in the deemed asset sale, the ceding company has remaining DAC or excess negative DAC, that remaining DAC is expensed or excess negative DAC is eliminated. See proposed § 1.338–11(e)(2).

Policyholders Surplus Account

Under section 815, as originally enacted by the Life Insurance Company Tax Act of 1959, stock life insurance companies were required to maintain a policyholders surplus account (PSA). Amounts contributed to a PSA were not included in income subject to tax under section 801. This deferral was based on the theory that such amounts may be necessary to meet future policyholders' claims.

The deferral afforded by section 815 generally terminated when there was a distribution from the PSA. For this purpose, a distribution included a distribution in partial or complete liquidation, a distribution in redemption of stock, dividend distributions other than distributions made by a corporation of its stock or rights to acquire its stock, payments attributable to distributions to shareholders made out of other accounts, payments in discharge of indebtedness attributable to distributions to shareholders made out of other accounts, and the balance of policyholders' surplus accounts on termination of life insurance status. See section 815, as originally enacted by the Life Insurance Company Tax Act of 1959; § 1.815–2(c); see also H.R. Conf. Rep. No. 34, 86th Cong., 1st Sess. 736 (1959), *Technical Explanation of the Life Insurance Company Income Tax Act of 1959*, at 762–64. However, a distribution did not include a carryover of the PSA to an acquiring corporation in a transaction described in section 381. Section 1.381(c)(22)–1(b)(7)(i); Rev. Rul. 77–248 (1977–2 C.B. 228). Therefore, distributions to a parent life insurance company of its subsidiary life insurance company's assets in the complete liquidation of the subsidiary under section 332 were not treated as distributions of the PSA subject to tax under section 801. See Rev. Rul. 77–248.

In 1984, Congress revised section 815 to prohibit further PSA contributions and to provide that any direct or indirect distribution to shareholders from the PSA would be subject to tax under section 801 in the year of the distribution. The legislative history indicates that the term *indirect distribution* is to be interpreted broadly to include both actual and constructive distributions of amounts in the PSA that directly or indirectly are used for the benefit of shareholders. See Staff of the Joint Committee on Taxation, 98th Cong., 2d Sess., *General Explanation of the Revenue Provisions of the Tax Reform Act of 1984*, at 594 (1984).

When a section 338(h)(10) election is made, old target is deemed to sell its assets for the ADSP and to distribute an amount equal to the proceeds of the stock sale, if any, to its shareholders in a deemed liquidation of old target. Section 332 generally applies to the receipt of this amount by the shareholder of an insurance company target. Although section 381 and the regulations thereunder provide that the PSA carries over to the acquiring corporation, the IRS and Treasury believe that where the acquiring corporation acquires less than 50 percent of old target's insurance business, such a rule is appropriate only to the extent that old target's insurance business is distributed in the section 381 transaction. To the extent that old target's insurance business is not distributed in a section 381 transaction, such amount is properly treated as a distribution of old target's PSA under section 815. When old target's PSA is separated from old target's insurance business, the purposes of the PSA are not served by further deferral because the old target's PSA is no longer necessary to meet future policyholders' claims. The separation of old target's PSA from old target's insurance business effects a distribution of those funds, even if the shareholder receiving the distribution has an insurance business of its own. See proposed amendments to § 1.381(c)(22)–1(b)(7) and § 1.338–11(f); see also Rev. Rul. 95–19 (1995–1 C.B. 143).

Recently, some courts have divided over whether the deemed asset sale resulting from a section 338(g) election gives rise to a distribution by old target of the PSA to its shareholders. Compare *Bankers Life and Casualty Co. v. United States*, 79 AFTR2d (RIA) 1726 (N.D. Ill. 1996), *aff'd on other grounds*, 142 F.3d 973 (7th Cir. 1998), *cert. denied*, 525 U.S. 961 (1998), with *GE Life and Annuity Co. v. United States*, 127 F. Supp.2d 794 (E.D. Va. 2000). In a transaction with respect to which an election has been made under section 338(g), old target's shareholders are treated as having sold their stock of old target. In addition, old target is deemed to have sold its assets to new target for their fair market value and to terminate its existence. Because there has been a separation of the value attributable to the PSA and old target's life insurance business for which it was maintained, and the shareholders receive that value in a transaction other than a section 381 transaction, the proposed regulation effectively provides that the deemed asset sale pursuant to a section 338(g) election effects a distribution of the PSA to old target's shareholders to the extent the grossed-up amount realized for the recently purchased stock exceeds the shareholders surplus account. See proposed § 1.338–11(f).

Section 847 Estimated Tax Payments

To the extent that old target is deemed to transfer its insurance business to new target as a result of the deemed asset sale, old target's special loss discount account under section 847(3) must be reduced to the extent attributable to such transferred insurance business and old target must include the amount of such reduction in gross income for the taxable year of the transaction. See proposed § 1.338–11(g).

However, if any of old target's insurance business is distributed to its shareholders in a section 381 transaction, the acquiring corporation succeeds to the portion of old target's special loss discount account that is attributable to the insurance business that is transferred to the acquiring corporation. See proposed § 1.381(c)(22)–1(b)(14). This rule is intended to apply to both life and non-life insurance companies. Old target may apply the balance of its special estimated tax account as a credit against any tax resulting from the inclusion of this income. Because old target ceases to exist for Federal income tax purposes, any special estimated tax payments remaining after the credit are voided.

Section 846(e) Election

Under section 846(e), an insurance company may elect to compute discounted unpaid losses for all eligible lines of business using its historical payment pattern as shown on the most recent annual statement filed before the accident year instead of the historical payment pattern determined by the Commissioner. The election can only be made in a determination year, as defined by section 846(d), for the year in which the election is made and the four succeeding accident years.

Because new target is generally treated as a new corporation that may adopt its own accounting methods without regard to the methods used by old target

(§ 1.338–1(b)), new target is not permitted to apply old target's experience as a result of any section 846(e) election made by old target under section 846. Thus, the proposed regulations do not provide any special rules under section 846.

Proposed Effective Dates

In general, these amendments are proposed to be applicable when filed as final regulations with the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations do not have a substantial economic impact because they merely provide guidance about the operation of the tax law in the context of acquisitions of insurance companies and businesses. Moreover, they are expected to apply predominantly to transactions involving larger businesses. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) and comments sent via the Internet that are submitted (in the manner described under the "ADDRESSES" portion of this preamble) timely to the IRS. The Department of the Treasury and the IRS specifically request comments on the clarity of the proposed regulations and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for September 18, 2002, beginning at 10 a.m. in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. All visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" portion of this preamble.

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

Persons who wish to present oral comments at the hearing must submit written or electronic comments and an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by August 28, 2002.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.338–11 is also issued under 26 U.S.C. 338. * * *

Par. 2. In § 1.197–0, the entries in the table of contents for § 1.197–2, paragraph (g)(5) are revised to read as follows:

§ 1.197–0 Table of contents.

This section lists the headings that appear in § 1.197–2.

§ 1.197–2 Amortization of goodwill and certain other intangibles.

* * * * *

(g) * * *
(5) Treatment of certain insurance contracts.
(i) Determination of adjusted basis of amortizable section 197 intangibles with respect to insurance contracts under section 197(f)(5).
(A) In general.
(B) Assumption reinsurance transactions.
(C) Amount paid or incurred by the reinsurer for the insurance contracts.
(D) Amount required to be capitalized under section 848 in connection with the transaction.
(*1*) In general.
(*2*) Cross references and special rules.
(E) Example.
(ii) Application of loss disallowance rule upon a disposition of an insurance contract acquired in an assumption reinsurance transaction.
(A) Disposition.
(*1*) In general.
(*2*) Treatment of indemnity reinsurance transactions.
(B) Loss.
(C) Examples.
(iii) Effective Date.
* * * * *

Par. 3. Section 1.197–2 is amended by revising paragraph (g)(5) to read as follows:

§ 1.197–2 Amortization of goodwill and certain other intangibles.

* * * * *

(g) * * *

(5) *Treatment of certain insurance contracts*—(i) *Determination of adjusted basis of amortizable section 197 intangibles with respect to insurance contracts under section 197(f)(5)*—(A) *In general*. Section 197 generally applies to insurance contracts acquired from another person through an assumption reinsurance transaction. Section 197(f)(5) determines the basis of an amortizable section 197

intangible with respect to insurance contracts acquired in an assumption reinsurance transaction. The basis of such an intangible is the excess of the amount paid or incurred by the acquirer (reinsurer) for the relevant insurance contract or group of insurance contracts (hereinafter insurance contracts) over the amount, if any, required to be capitalized under section 848 in connection with such transaction. For purposes of this paragraph (g)(5), the term *insurance contracts* includes an annuity contract or group of annuity contracts.

(B) *Assumption reinsurance transactions*. An assumption reinsurance transaction means an arrangement whereby the reinsurer becomes solely liable to the policyholders on insurance contracts transferred by the ceding company. Thus, the transfer of insurance contracts and assumption of related liabilities deemed to occur by reason of a section 338 election for a target insurance company is treated as an assumption reinsurance transaction.

(C) *Amount paid or incurred by the reinsurer for the insurance contracts*. The amount paid or incurred to acquire insurance contracts is—

(*1*) In a deemed asset sale resulting from an election under section 338, the amount of the AGUB allocable thereto (see §§ 1.338–6 and 1.338–11(b)(2));

(*2*) In an applicable asset acquisition within the meaning of section 1060, the amount of the consideration allocable thereto (see §§ 1.338–6, 1.338–11(b)(2), and 1.1060–1(c)(5)); and

(*3*) In any other transaction, the excess of the increase in the reinsurer's tax reserves resulting from the transaction (computed in accordance with sections 807, 832(b)(4)(B), and 846) over the value of the net assets received from the ceding company in the transaction.

(D) *Amount required to be capitalized under section 848 in connection with the transaction*—(1) *In general*. With respect to specified insurance contracts (as defined in section 848(e)) acquired in an assumption reinsurance transaction, the amount required to be capitalized under section 848 in connection with the acquisition of the relevant contracts is determined by multiplying the reinsurer's specified policy acquisition expenses for that taxable year by a fraction, the numerator of which is the reinsurer's tentative positive capitalization amount for the relevant acquired insurance contracts and the denominator of which is the reinsurer's total tentative positive capitalization amount for the taxable year with regard to all specified insurance contracts. For purposes of this paragraph, the tentative positive capitalization amount for the relevant acquired insurance contracts is determined by multiplying the net positive consideration received by the reinsurer in the assumption reinsurance transaction for the insurance contracts by the percentage factor applicable to the insurance contracts under section 848(c). The reinsurer's total tentative positive capitalization amount for the taxable year is the sum of—

(*i*) 1.75 percent of the net premiums for the taxable year on annuity contracts;

(*ii*) 2.05 percent of the net premiums for the taxable year on group life insurance contracts; and

(*iii*) 7.7 percent of the net premiums for the taxable year on specified insurance contracts other than annuity or group life insurance contracts.

(*2*) *Cross references and special rules*. In general, for rules applicable to the determination of specified policy acquisition expenses, net premiums, and net positive consideration, see section 848(c) and (d), and § 1.848–2(a) and (f). However, the following special rules apply solely for purposes of this paragraph (g)(5)(i)(D)—

(*i*) Specified policy acquisition expenses cannot be less than zero;

(*ii*) Net premiums for the taxable year cannot be less than the sum of the positive consideration for all contracts acquired by the reinsurer in assumption reinsurance transactions during the applicable taxable year;

(*iii*) In computing general deductions (as defined in section 848(c)(2)), one-half of the amount paid or incurred by the reinsurer in the assumption reinsurance transaction is treated as a section 197 intangible for which an amortization deduction is allowed under section 197(a); and

(*iv*) Any reduction of specified policy acquisition expenses pursuant to an election under § 1.848–2(i)(4) (relating to an assumption reinsurance transaction with an insolvent ceding company) is disregarded.

(E) *Example*. The following example illustrates this paragraph (g)(5)(i):

Example. (i) *Facts*. On January 15, P purchases all the stock of T, an insurance company, in a qualified stock purchase and makes a section 338 election for T. T is the issuer of a group life insurance contract. Under §§ 1.338–6 and 1.338–11(b)(2), the amount of AGUB allocable to the group contract is $15. P and new T are calendar year taxpayers. New T's net premiums for the taxable year are $10,000, which includes $500 net consideration with respect to the group contract transferred in the transaction. The remaining $9,500 of new T's net premiums are on life insurance contracts that are not group contracts. New T's specified policy acquisition expenses for the taxable year, excluding the amortization of any section 197 intangible acquired in this transaction, are $199.50.

(ii) *Analysis*. The deemed asset sale resulting from the election under section 338 is an assumption reinsurance transaction because new T becomes solely liable to policyholders on contracts for which old T formerly was liable. New T's adjusted basis in the group life insurance contract immediately following the assumption reinsurance transaction is determined as follows. The amount paid or incurred by new T in the assumption reinsurance transaction with respect to the contract is $15. Solely for purposes of computing the basis of new T's amortizable section 197 intangible under section 197(f)(5), new T's specified policy acquisition expenses for the year of the transaction equal $200.00 ($199.50 of other specified policy acquisition expenses for the year + $0.50 of assumed amortization expense under section 197, derived by treating one-half of the amount paid or incurred for the contract as a section 197 intangible for which an amortization deduction is allowed ($15.00 x 1/2 x 1/15)). To determine the amount required to be capitalized under section 848 in connection with the acquisition of the group contract, new T multiplies the $200 of specified policy acquisition expenses for the taxable year by a fraction, the numerator of which is $10.25 ($500 x 2.05%) and the denominator of which is $741.75 (($500 x 2.05%) + ($9,500 x 7.7%)). Thus, for purposes of applying section 197(f)(5), new T is treated as capitalizing $2.76 ($200 x $10.25 ÷ $741.75) under section 848 in connection with the acquisition of the group contract. Accordingly, the adjusted basis of the group contract under section 197(f)(5) is $12.24, the excess of the amount paid or incurred by the reinsurer for the group contract in the assumption reinsurance transaction ($15) over the amount treated as capitalized under section 848 in connection with the transaction ($2.76). New T amortizes the $12.24 adjusted basis of the group contract over 15 years under section 197. New T deducts the remaining $2.76 of the $15 of AGUB allocable to the contract because it is reflected in amounts new T capitalizes under section 848. In computing its actual capitalization under section 848 for the taxable year, new T takes into account its actual amortization under section 197 (*i.e.*, $12.24 x 1/15 =

$0.82) rather than the $0.50 assumed for the purpose of determining basis under section 197(f)(5).

(ii) *Application of loss disallowance rule upon a disposition of an insurance contract acquired in an assumption reinsurance transaction*. The following rules apply for purposes of applying the loss disallowance rules of section 197(f)(1)(A) to the disposition of a section 197(f)(5) intangible. For this purpose, a section 197(f)(5) intangible is an amortizable section 197 intangible the basis of which is determined under section 197(f)(5).

(A) *Disposition*— (*1*) *In general*. A disposition of a section 197 intangible is any event as a result of which, absent section 197, recovery of basis is otherwise allowed for Federal income tax purposes.

(*2*) *Treatment of indemnity reinsurance transactions*. The transfer through indemnity reinsurance of the right to the future income from the insurance contracts to which a section 197(f)(5) intangible relates does not necessarily preclude the recovery of basis by the ceding company, provided that sufficient economic rights relating to the reinsured contracts are transferred to the reinsurer. However, the ceding company is not permitted to recover basis in an indemnity reinsurance transaction if it has a right to experience refunds reflecting a significant portion of the future profits on the reinsured contracts, or if it retains an option to reacquire a significant portion of the future profits on the reinsured contracts through the exercise of a recapture provision. In addition, the ceding company is not permitted to recover basis in an indemnity reinsurance transaction if the reinsurer assumes only a limited portion of the ceding company's risk relating to the reinsured contracts (*e.g.*, excess loss reinsurance).

(B) *Loss*. The loss, if any, recognized by a taxpayer on the disposition of a section 197(f)(5) intangible equals the amount by which the taxpayer's adjusted basis in the section 197(f)(5) intangible immediately prior to the disposition exceeds the amount, if any, that the taxpayer receives from another person for the future income right from the insurance contracts to which the section 197(f)(5) intangible relates. In determining the amount of the taxpayer's loss on the disposition of a section 197(f)(5) intangible through a reinsurance transaction, any effect of the transaction on the amounts capitalized by the taxpayer as specified policy acquisition expenses under section 848 is disregarded.

(C) *Examples*. The following examples illustrate the principles of this paragraph (g)(5)(ii):

Example 1—(i) *Facts*. In a prior taxable year, as a result of a section 338 election with respect to T, new T was treated as purchasing all of old T's insurance contracts that were in force on the acquisition date in an assumption reinsurance transaction. Under §§ 1.338–6 and 1.338–11(b)(2), the amount of AGUB allocable to the future income right from the purchased insurance contracts was $15, net of the amounts required to be capitalized under section 848 as a result of the assumption reinsurance transaction. At the beginning of the current taxable year, as a result of amortization deductions allowed by section 197(a), new T's adjusted basis in the section 197(f)(5) intangible resulting from the assumption reinsurance transaction is $12. During the current taxable year, new T enters into an indemnity reinsurance agreement with R, another insurance company, in which R assumes 100 percent of the risk relating to the insurance contracts to which the section 197(f)(5) intangible relates. In the indemnity reinsurance transaction, R agrees to pay new T a ceding commission of $10 in exchange for the future profits on the underlying reinsured policies. Under the indemnity reinsurance agreement, new T continues to administer the reinsured policies, but transfers investment assets equal to the required reserves for the reinsured policies together with all future premiums to R. The indemnity reinsurance agreement does not contain an experience refund provision or a provision allowing new T to terminate the reinsurance agreement at its sole option. New T retains the insurance licenses and other amortizable section 197 intangibles acquired in the deemed asset sale and continues to underwrite and issue new insurance contracts.

(ii) *Analysis*. The indemnity reinsurance agreement constitutes a disposition of the section 197(f)(5) intangible because it involves the transfer of sufficient economic rights attributable to the insurance contracts to which the section 197(f)(5) intangible relates such that recovery of basis is allowed. For purposes of applying the loss disallowance rules of section 197(f)(1) and paragraph (g) of this section, new T's loss is $2 (new T's adjusted basis in the section 197(f)(5) intangible immediately prior to the disposition ($12) less the ceding commission ($10)). Therefore, new T applies $10 of the adjusted basis in the section 197(f)(5) intangible against the amount received from R for the future income right on the reinsured policies and increases its basis in the amortizable section 197 intangibles that it acquired and retained from the deemed asset sale by $2, the amount of the disallowed loss. The amount of new T's disallowed loss under section 197(f)(1)(A) is determined without regard to the effect of the indemnity reinsurance transaction on the amounts capitalized by new T as specified policy acquisition expenses under section 848.

Example 2—(i) *Facts*. Assume the same facts as in *Example 1*, except that under the indemnity reinsurance agreement R agrees to pay new T a ceding commission of $5 with respect to the underlying reinsured contracts. In addition, under the indemnity reinsurance agreement, new T is entitled to an experience refund equal to any future profits on the reinsured contracts in excess of the ceding commission plus an annual risk charge. New T also has a right to recapture the business at any time after R has recovered an amount equal to the ceding commission.

(ii) *Analysis*. The indemnity reinsurance agreement between new T and R does not represent a disposition because it does not involve the transfer of sufficient economic rights with respect to the future income on the reinsured contracts. Therefore, new T may not recover its basis in the section 197(f)(5) intangible to which the contracts relate and must continue to amortize ratably the adjusted basis of the section 197(f)(5) intangible over the remainder of the 15-year recovery period and cannot apply any portion of this adjusted basis to offset the ceding commission received from R in the indemnity reinsurance transaction.

(iii) *Effective date*. This paragraph (g)(5) is applicable to acquisitions and dispositions on or after the date it is filed as a final regulation with the **Federal Register**. For rules applicable to acquisitions and dispositions on or before that date, see § 1.197–2 in effect prior to that date (see 26 CFR part 1, revised April 1, 2001).

* * * * *

Par. 4. Section 1.338–0 is amended by adding entries to the outline of topics for § 1.338–11 to read as follows:

§ 1.338–0 Outline of topics.

* * * * *

§ 1.338–11 Effect of section 338 election with respect to insurance company target.

(a) In general.
(b) Computation of ADSP and AGUB.
(1) Reserves as an assumed liability.
(2) Allocation of AGUB and ADSP to specific insurance contracts.
(c) Application of assumption reinsurance principles.
(1) In general.
(2) Reinsurance premium amount.
(3) Ceding commission.
(4) Examples.
(d) Reserve increases by new target after the deemed asset sale.
(1) In general.
(2) Exceptions.
(3) Increases in unpaid loss reserves.
(4) Increases in other reserves.
(5) DAC characteristics of the premium resulting from an adjustment.

(6) Subsequent dispositions of amortizable section 197 intangibles with respect to insurance contracts.
(7) Examples.
(e) Effect of section 338 election on old target's capitalization amounts under section 848.
(1) Determination of net consideration for specified insurance contracts.
(2) Determination of capitalization amount.
(3) Section 381 transactions.
(f) Effect of section 338 election on policyholders surplus account.
(g) Effect of section 338 election on section 847 special estimated tax payments.
(h) Effective date.

Par. 5. Section 1.338–1 is amended by revising the last two sentences of paragraph (a)(2) and adding a sentence before the last sentence of paragraph (a)(3), to read as follows:

§ 1.338–1 General principles; status of old target and new target.

(a) * * *

(2) * * * For example, if the target is an insurance company for which a section 338 election is made, the deemed asset sale results in an assumption reinsurance transaction with respect to the insurance contracts deemed transferred from old target to new target. See, generally, § 1.817–4(d), and for specific rules regarding transactions to which section 338 applies, § 1.338–11.

(3) * * * Section 1.338–11 provides special rules for insurance company targets. * * *

* * * * *

Par. 6. Section 1.338–11 is added to read as follows:

§ 1.338–11 Effect of section 338 election with respect to insurance company target.

(a) *In general*. This section provides rules that apply where an election under section 338 is made with respect to a target that is an insurance company. The rules in this section apply in addition to those generally applicable upon the making of an election under section 338. In the case of a conflict between the provisions of this section and other provisions of the Internal Revenue Code or regulations, the rules set forth in this section determine the Federal income tax treatment of the parties and the transaction where a section 338 election is made with respect to an insurance company target.

(b) *Computation of ADSP and AGUB*—(1) *Reserves as an assumed liability*. For purposes of computing ADSP and AGUB under §§ 1.338–4 and 1.338–5, old target's reserves for Federal income tax purposes with respect to any insurance, annuity, and reinsurance contracts deemed sold by old target to new target in the deemed asset sale will be treated as liabilities of old target assumed by new target. Such reserves are those properly taken into account by old target with respect to such contracts at the close of the taxable year ending on the acquisition date (before giving effect to the deemed asset sale and assumption reinsurance transaction). Such reserves are hereinafter referred to as old target's tax reserves.

(2) *Allocation of AGUB and ADSP to specific insurance contracts*. For purposes of allocating AGUB and ADSP pursuant to §§ 1.338–6 and 1.338–7, the fair market value of a specific insurance, reinsurance or annuity contract or group of insurance, reinsurance or annuity contracts (hereinafter insurance contracts) is the amount of the ceding commission a willing reinsurer would pay a willing ceding company in an arm's length transaction for the reinsurance of the contracts if the gross reinsurance premium for the contracts were equal to old target's tax reserves for the contracts. See § 1.197–2(g)(5) for rules concerning the treatment of the amount allocable to insurance contracts acquired in the deemed asset sale.

(c) *Application of assumption reinsurance principles*—(1) *In general*. If a target is an insurance company, the deemed sale of insurance contracts is treated for Federal income tax purposes as an assumption reinsurance transaction between old target, as the reinsured or ceding company, and new target, as the reinsurer or acquiring company, at the close of the acquisition date. The Federal income tax treatment of the assumption reinsurance transaction is determined under the applicable provisions of subchapter L, chapter 1, subtitle A of the Internal Revenue Code, as modified by the rules set forth in this section.

(2) *Reinsurance premium amount*. In general, the gross amount of the premium paid by old target in the assumption reinsurance transaction is equal to the amount of old target's tax reserves with respect to the contracts deemed transferred from old target to new target, as computed in paragraph (b)(1) of this section. Thus, old target is entitled to a deduction for this amount, and includes in income the ceding commission, if any, deemed received from new target. New target is deemed to receive a reinsurance premium from old target in the amount of the reserves for the contracts and to pay old target the amount of any ceding commission, as computed in paragraph (c)(3) of this section.

(3) *Ceding commission*. Old target is deemed to receive a ceding commission in an amount equal to the amount of ADSP allocated to the insurance contracts transferred in the assumption reinsurance transaction, as determined under §§ 1.338–6 and 1.338–7 and paragraph (b) of this section. New target is deemed to pay a ceding commission in an amount equal to the amount of AGUB allocated to the insurance contracts acquired in the assumption reinsurance transaction, as determined under §§ 1.338–6 and 1.338–7 and paragraph (b) of this section.

(4) *Examples*. The following examples illustrate this paragraph (c):

Example 1—(i) *Facts*. On January 1, 2003, T, an insurance company, has the following assets with the following fair market values: $10 cash, $30 of securities, $10 of equipment, a life insurance contract having a value, under paragraph (b)(2) of this section, of $17, and goodwill and going concern value. T has tax reserves of $50 and no other liabilities. On January 1, 2003, P purchases all of the stock of T for $16 and makes a section 338 election for T. For purposes of the capitalization requirements of section 848, assume new T has $20 of general deductions in its first taxable year ending on December 31, 2003, and earns no other premiums during the year.

(ii) *Analysis*. (A) For Federal income tax purposes, the section 338 election results in a deemed sale of the assets of old T to new T. Old T's ADSP is $66 ($16 amount realized for the T stock plus $50 liabilities). New T's AGUB also is $66 ($16 basis for the T stock plus $50 liabilities). See paragraph (b)(1) of this section. Each of the AGUB and ADSP is allocated under the residual method of § 1.338–6 to determine the purchase or sale price of each asset transferred. Each of the AGUB and ADSP is allocated as follows: $10 to cash (Class I), $30 to the securities (Class II), $10 to equipment (Class V), $16 to the life insurance contract (Class VI), and $0 to goodwill and going concern value (Class VII).

(B) Under section 1001, old T's amount realized with respect to the securities is $30 and with respect to the equipment is $10. As a result of the deemed asset sale, there is an assumption reinsurance transaction between old T (as ceding company) and new T (as reinsurer) at the close of the acquisition date with respect to the life insurance contract issued by old T. See paragraph (c)(1) of this section. Although the assumption reinsurance transaction results in a $50 decrease in old T's reserves, which is taxable income to old T, the reinsurance premium paid by old T is deductible by old T. Under paragraph (c)(2) of this section, old T is deemed to pay a reinsurance premium equal to the reserve for the life insurance contract immediately before the deemed asset sale ($50) and is deemed to receive a ceding commission from new T. Under paragraph (c)(3) of this section, the portion of the ADSP allocated to the life insurance contract is $16; thus, the ceding commission is $16. Old T, therefore, is deemed to pay new T a reinsurance premium of $34 ($50 - $16 = $34). Old T also has $34 of net negative consideration for purposes of section 848. See paragraph (e) of this section for rules relating to the effect of a section 338 election on the capitalization of amounts under section 848.

(C) New T obtains an initial basis of $30 in the securities and $10 in the equipment. New T is deemed to receive a reinsurance premium from old T in an amount equal to the $50 of reserves for the life insurance contract and to pay old T a $16 ceding commission for the contract. See paragraphs (c)(2) and (3) of this section. Accordingly, new T includes $50 of premium in income and deducts $50 for its increase in reserves. For purposes of section 848, new T has $34 of net positive consideration with regard to the deemed assumption reinsurance transaction. Because the only contract involved in the deemed assumption reinsurance transaction is a life insurance contract, new T must capitalize $2.62 ($34 x 7.7% = $2.62) under section 848. New T will amortize the $2.62 as provided under section 848. New T's adjusted basis in the life insurance contract, which is an amortizable section 197 intangible, is $13.38, the excess of the $16 ceding commission over the $2.62 capitalized under section 848. See section 197 and § 1.197–2(g)(5). New T deducts the $2.62 of the ceding commission that is not amortizable under section 197 because it is reflected in the amount capitalized under section 848 and also deducts the remaining $17.38 of its general deductions.

Example 2—(i) *Facts*. Assume the same facts as in *Example 1*, except the life insurance contract has a value of $0. Thus, to reinsure the contract in an arm's length transaction, T would have to pay the reinsurer a reinsurance premium in excess of T's $50 of tax reserves for the contract.

(ii) *Analysis*. (A) For Federal income tax purposes, the section 338 election results in a deemed sale of the assets of old T to new T. Old T's ADSP is $66 ($16 amount realized for the T stock plus $50 liabilities). New T's AGUB also is $66 ($16 basis for the T stock plus $50 liabilities). See paragraph (b)(1) of this section. Each of the AGUB and ADSP is allocated under the residual method of § 1.338–6 to determine the purchase or sale price of each asset transferred. Each of the AGUB and ADSP is allocated as follows: $10 to cash (Class I), $30 to the securities (Class II), $10 to the equipment (Class V), $0 to the life insurance contract (Class VI), and $16 to goodwill and going concern value (Class VII).

(B) Under section 1001, old T's amount realized with respect to the securities is $30 and with respect to the equipment is $10. As a result of the deemed asset sale, there is an assumption reinsurance transaction between old T (as ceding company) and new T (as reinsurer) at the close of the acquisition date with respect to the life insurance contract issued by old T. See paragraph (c)(1) of this section. Although the assumption reinsurance transaction results in a $50 decrease in old T's reserves, which is taxable income to old T, the reinsurance premium deemed paid by old T to new T is deductible by old T. Under paragraph (c)(2) of this section, old T is deemed to pay a reinsurance premium equal to the reserve for the life insurance contract immediately before the deemed asset sale ($50), and is deemed to receive from new T a ceding commission equal to the amount of AGUB allocated to the life insurance contract ($0), as provided in paragraph (c)(3) of this section. Old T also has $50 of net negative consideration for purposes of section 848. See paragraph (e) of this section for rules relating to the effect of a section 338 election on capitalization amounts under section 848.

(C) New T obtains an initial basis of $30 in the securities and $10 in the equipment. New T is deemed to receive a reinsurance premium from old T in an amount equal to the $50 of reserves for the life insurance contract. Accordingly, new T includes $50 of premium in income and deducts $50 for its increase in reserves. For purposes of section 848, new T has $50 of net positive consideration with respect to the deemed assumption reinsurance transaction. Because the only contract involved in the assumption reinsurance transaction is a life insurance contract, new T must capitalize $3.85 ($50 x 7.7%) under section 848 from the transaction and deducts the remaining $16.15 of its general deductions. Because new T allocates $0 of the AGUB to the insurance contract, no amount is amortizable under section 197 with respect to the insurance contract. See paragraph (d) of this section for rules on adjustments required if, before the end of 2006, new T increases its reserves for, or reinsures at a loss, the acquired life insurance contract.

(d) *Reserve increases by new target after the deemed asset sale*—(1) *In general*. If, during any of its first four taxable years, new target increases its reserves for any insurance contracts acquired in the deemed asset sale (acquired contracts), new target shall be treated as receiving in that year the sum of the positive amounts, if any, described in paragraphs (d)(3) and (4) of this section as an additional premium for the acquired insurance contracts in the assumption reinsurance transaction (described in paragraph (c)(1) of this section) that occurred in connection with the deemed asset sale and will include such amount in income, and such amount will increase AGUB. See §§ 1.338–5(b)(2)(ii) and 1.338–7. Old target makes no adjustments to ADSP under this paragraph (d).

(2) *Exceptions*. New target is not required to take into account reserve increases under this paragraph (d)—

(i) To the extent such increases occur while it is under state receivership; or

(ii) To the extent its deduction for the reserve increase is spread under section 807(f) over the 10 succeeding taxable years.

(3) *Increases in unpaid loss reserves*. The amount of reserve increases, if any, taken into account under this paragraph (d) with respect to unpaid losses on acquired contracts is computed using the formula A/B x (C - [D + E]) where—

(i) A equals old target's discounted unpaid losses (determined under section 846) used to compute the tax reserves included in AGUB under paragraph (b)(1) of this section;

(ii) B equals old target's undiscounted unpaid losses (as defined by section 846(b)(1)) used to compute the tax reserves included in AGUB under paragraph (b)(1) of this section;

(iii) C equals new target's undiscounted unpaid losses (as defined by section 846(b)(1)) at the end of the taxable year that are attributable to losses incurred by old target on or before the acquisition date;

(iv) D (which may be a negative number) equals the amount determined by—

(A) Multiplying old target's undiscounted unpaid losses (as defined by Section 846(b)(1)) by 1.02 for new target's first taxable year, 1.04 for new target's second taxable year, 1.06 for new target's third taxable year, or 1.08 for new target's fourth taxable year; and

(B) Subtracting the cumulative amount of losses, loss adjustment expenses, and reinsurance premiums paid by new target through the end of the taxable year with regard to losses incurred by old target on or before the acquisition date; and

(v) E equals the cumulative amount of the undiscounted unpaid losses taken into account in prior taxable years by new target as adjustments to reserves with regard to losses incurred by old target on or before the acquisition date.

(4) *Increases in other reserves*. The amount of the increases in reserves other than unpaid loss reserves is taken into account under this paragraph (d) to the extent of any net increase (in the aggregate) in reserves for acquired contracts

due to changes in methodology or assumptions used to compute the reserves for those contracts (including the adoption by new target of a methodology or assumptions different from those used by old target).

(5) *DAC characteristics of the premium resulting from an adjustment*. For purposes of applying section 848, the additional premium arising from the adjustment under this paragraph (d) is allocated among each category of specified insurance contracts under section 848(c)(1) (and contracts that are not specified insurance contracts) as follows—

(i) For each category of specified insurance contracts (and contracts that are not specified insurance contracts), by taking the sum of that category's contribution to the amounts in paragraphs (d)(3) and (4) of this section; and

(ii) Dividing the additional premium described in paragraph (d)(1) of this section in proportion to the positive sums for each category from paragraph (d)(5)(i) of this section.

(6) *Subsequent dispositions of amortizable section 197 intangibles with respect to insurance contracts*. For rules regarding subsequent dispositions of contracts acquired in the deemed asset sale, see also § 1.197–2(g)(5)(ii).

(7) *Examples*. The following examples illustrate this paragraph (d):

Example 1—(i) *Facts*. On January 1, 2003, P purchases all of the stock of T, a non-life insurance company, for $120 and makes a section 338 election for T. On the acquisition date, old T has total reserve liabilities under state law of $725, consisting of undiscounted unpaid losses of $625 and unearned premiums of $100. Old T's tax reserves on the acquisition date are $580, which consist of discounted unpaid losses (as defined in section 846) of $500 and unearned premiums (as computed under section 832(b)(4)(B)) of $80. Old T has assets in Classes I through V with a fair market value of $700. As of the beginning of January 1, 2003, old T also has Class VI assets with a value of $75, consisting of the future profit stream on certain insurance contracts. During 2003, new T makes loss adjustment expense payments of $200 with respect to the unpaid losses incurred by old T prior to the acquisition date. As of December 31, 2003, new T reports undiscounted unpaid losses of $435 attributable to losses incurred prior to the acquisition date. The related amount of discounted losses (as defined in section 846) for those losses is $360.

(ii) *Computation and allocation of AGUB*. Pursuant to § 1.338–5 and paragraph (b)(1) of this section, as of the acquisition date, AGUB is $700, reflecting the sum of the amount paid for old T's stock ($120) and the tax reserves assumed by new T in the transaction ($580). Under § 1.338–6, new T allocates the AGUB to each of the assets in Class I through V up to their fair market value. No AGUB is available for the assets in Class VI, even though the future profit stream on old T's insurance contracts has a fair market value of $75 on the acquisition date.

(iii) *Adjustments for increases in reserves with respect to unpaid losses*. Pursuant to paragraph (d) of this section, new T must determine whether any amounts by which it increased its unpaid loss reserves will be treated as an additional premium. New T applies the formula of paragraph (d)(3) of this section, where A equals $500, B equals $625, C equals $435, D equals $437.50 [($625 x 1.02) - $200], and E equals $0. Under the formula, new T is not subject to an adjustment for 2003 because new T's undiscounted unpaid losses at the end of the taxable year ($435) do not exceed $437.50, the adjusted amount of undiscounted unpaid losses used in computing AGUB reduced by loss payments through the end of the taxable year [($625 x 1.02) - $200].

Example 2—(i) *Facts*. Assume the same facts as in *Example 1*. Further assume that during 2004 new T deducts total loss and expense payments of $375 with respect to losses incurred by old T prior to the acquisition date. On December 31, 2004, new T reports undiscounted unpaid losses of $150 with respect to losses incurred prior to the acquisition date. The related amount of discounted unpaid losses (as defined in section 846) for those losses is $125.

(ii) *Analysis*. New T must determine whether any amounts by which it increased its unpaid loss reserves during 2004 will be treated as an additional premium under paragraph (d) of this section. New T applies the formula of paragraph (d)(3) of this section, where A equals $500, B equals $625, C equals $150, D equals $75 [($625 x 1.04) - $575], and E equals $0. Pursuant to paragraph (d) of this section, new T must recognize additional premium income in 2004 of $60.00 (($500/$625) x ($150 - [$75+$0]) to offset the section 832(b)(5) deduction for amounts by which it increased those reserves and must adjust the amount of AGUB allocable to acquired insurance contracts (Class VI assets) to reflect the increase in AGUB attributable to the $60.00 adjustment for increases in reserves. See section 197 and the regulations thereunder for the treatment of the amounts allocable to the insurance contracts.

Example 3—(i) *Facts*. Assume the same facts as in *Example 2*. Further assume that on January 1, 2005, new T reinsures the outstanding liability with respect to losses incurred by old T prior to the acquisition date through a portfolio reinsurance transaction with R, another non-life insurance company. In this transaction, R agrees to assume any remaining liability with respect to losses incurred prior to the acquisition date in exchange for a reinsurance premium of $175. Accordingly, as of December 31, 2005, new T reports no undiscounted unpaid losses with respect to losses incurred by old T prior to the acquisition date.

(ii) *Analysis*. New T must determine whether any amounts by which it increased its unpaid loss reserves will be treated as an additional premium under paragraph (d) of this section. New T applies the formula of paragraph (d)(3) of the section, where A equals $500, B equals $625, C equals $0, D equals -$87.50 [($625 x 1.06) - ($575 + $175) = -$87.50], and E equals $75. New T must include $10.00 (($500/$625) x ($0 - [-$87.50 + $75]) in gross income for 2005 to offset the section 832(b)(5) deduction for increases to its unpaid loss reserve and must increase the AGUB allocable to the acquired insurance contracts (Class VI assets) by this amount. See section 197 and the regulations thereunder for the treatment of the amounts allocable to the insurance contracts.

(e) *Effect of section 338 election on old target's capitalization amounts under section 848*—(1) *Determination of net consideration for specified insurance contracts*. For purposes of applying section 848 and § 1.848–2(f) to the deemed assumption reinsurance transaction, old target's net consideration (either positive or negative) with respect to each category of specified insurance contracts is an amount equal to—

(i) The allocable portion of the ceding commission (if any) relating to contracts in that category; less

(ii) The amount by which old target's tax reserves for contracts in that category has been reduced as a result of the deemed assumption reinsurance transaction.

(2) *Determination of capitalization amount*. Except as provided in § 1.381(c)(22)–1(b)(13)—

(i) If, after the deemed asset sale, old target has an amount otherwise required to be capitalized under section 848 for the taxable year or an unamortized balance of specified policy acquisition expenses from prior taxable years, then old target deducts such remaining amount or unamortized balance as an expense incurred in the taxable year that includes the acquisition date; and

(ii) If, after the deemed asset sale, the negative capitalization amount resulting from the reinsurance transaction exceeds the amount that old target can deduct under section 848(f)(1), then old target's capitalization amount is treated as zero at the close of the taxable year that includes the acquisition date.

(3) *Section 381 transactions*. For transactions described in section 381, see § 1.381(c)(22)–1(b)(13).

(f) *Effect of section 338 election on policyholders surplus account*. Except as specifically provided in § 1.381(c)(22)–1(b)(7), the deemed asset sale effects a distribution of old target's policyholders surplus account to the extent the grossed-up amount realized on the sale to the purchasing corporation of the purchasing corporation's recently purchased target stock (as defined in § 1.338–4(c)) exceeds old target's shareholders surplus account under section 815(c).

(g) *Effect of section 338 election on section 847 special estimated tax payments*. If old target had elected to claim an additional deduction under section 847 for taxable years prior to and including the acquisition date, the amount remaining in old target's special loss discount account under section 847(3) must be reduced to the extent it relates to contracts transferred to new target and the amount of such reduction must be included in old target's gross income for the taxable year that includes the deemed assumption reinsurance transaction. Old target may apply the balance of its special estimated tax account as a credit against any tax resulting from such inclusion in gross income. Any special estimated tax payments remaining after this credit are voided and, therefore, are not available for credit or refund. Pursuant to section 847(1), new target is permitted to claim a section 847 deduction with respect to losses incurred prior to the deemed asset sale, subject to the general requirement that new target makes timely special estimated tax payments equal to the tax benefit resulting from this deduction. See § 1.381(c)(22)–1(c)(14) regarding the carryover of the special loss discount account attributable to contracts transferred in a section 381 transaction.

(h) *Effective date*. This section applies to a section 338 election for a target if the acquisition date is on or after the date this section is filed as a final regulation with the **Federal Register**.

Par. 7. Section 1.381(c)(22)–1 is amended by:

1. Adding a sentence to the end of paragraph (b)(7)(i).

2. Redesignating existing (b)(7)(ii) as paragraph (b)(7)(iv) and adding new paragraphs (b)(7)(ii) and (b)(7)(iii).

3. Adding paragraphs (b)(7)(v), and (b)(13) and (b)(14).

The revisions read as follows:

§ 1.381(c)(22)–1 Successor life insurance company.

* * * * *

(b) * * *

(7)(i) * * * However, any amounts attributable to money or other property distributed to a person other than the acquiring corporation under section 381(a) (*e.g.*, boot) shall be treated as a distribution under section 815.

(ii) Notwithstanding paragraph (b)(7)(i) of this section, if the transferor corporation transfers less than 50 percent of its insurance business to the acquiring corporation, then the acquiring corporation shall succeed to a ratable portion of the dollar balances in the transferor's shareholders surplus account, policyholders surplus account, and other accounts. The percentage of such accounts to which the acquiring corporation succeeds is determined by the ratio of the transferor's insurance reserves for the contracts transferred to the acquiring corporation, as maintained under section 816(b), to the transferor's reserves for all of its contracts maintained under section 816(b) immediately before the earlier of the distribution or transfer or the adoption of the plan of liquidation or reorganization. For transactions in which the transferor liquidates pursuant to an election under section 338(h)(10), see § 1.338–11(f) for the treatment of its remaining policyholders surplus account. For all other transactions subject to this paragraph, the transferor must take into account as income its remaining policyholders surplus account to the extent the fair market value of its assets (net of liabilities) transferred to the acquiring corporation or to the transferor's shareholders pursuant to the plan of liquidation or reorganization exceeds the transferor's remaining shareholders surplus account.

(iii) If, pursuant to a plan in existence at the time of the liquidation or reorganization, the acquiring corporation transfers any insurance or annuity contract it received in the liquidation or reorganization to another person, then, for purposes of paragraph (b)(7)(ii) of this section, that contract shall be deemed to have been transferred by the transferor to that other person after the adoption of the plan of liquidation or reorganization. If the transferor is an old target within the meaning of § 1.338(h)(10)–1(d)(2), any transfer by the acquiring corporation to the purchasing corporation (as defined in § 1.338–2(c)(11)) or to any person related to the purchasing corporation within the meaning of section 197(f)(9)(C) within two years of the transfer described in section 381(a) will be presumed to have been pursuant to a plan in existence at the time of the liquidation or reorganization.

* * * * *

(v) The provisions of this paragraph (b)(7) are illustrated by the following examples:

Example 1. P buys the stock of insurance company target, T, from S for $16, and P and S make a section 338(h)(10) election for T. T transfers no insurance contracts to S, or any related party, in connection with the transaction. Further, assume that T had $10 in its policyholders surplus account and no balance in its shareholders surplus account or other accounts. Immediately before the deemed asset sale, old T is required to include as ordinary income the $10 in the policyholders surplus account.

Example 2. Assume the same facts as in *Example 1*, except that T holds a block of life insurance contracts P does not wish to acquire, and, immediately before the sale of T stock, S causes T to distribute the unwanted block of insurance contracts to S. Further, assume that S is an insurance company, that the distribution of contracts is treated as pursuant to a section 332 liquidation, and that old T's tax reserves with respect to the distributed contracts represent one-tenth of old T's tax reserves with respect to all of its life insurance contracts. Because T transfers less than 50 percent of its life insurance business to S pursuant to a section 332 liquidation, S succeeds to a ratable portion of old T's policyholders surplus account ($1), and old T includes as ordinary income the remaining $9 of that account.

Example 3. Assume the same facts as in *Example 2*, except that 14 months after the deemed asset sale, S and X, a person related to new T under section 197(f)(9)(C), engage in an indemnity reinsurance transaction involving the contracts transferred to S from old T. Because X is related to the purchasing corporation (P) under section 197(f)(9)(C), and X receives contracts from the acquiring corporation (S) that S acquired from old T within two years of the transfer from old T to S, the contracts are presumed to have been transferred pursuant to a plan in existence at the time of old T's liquidation. If S cannot establish otherwise, old T is treated as having distributed the remainder of its policyholders surplus account. In that case, in the taxable year of the indemnity reinsurance transaction, S takes into account as ordinary income the portion of old T's accounts ($9) that old T or S has not previously taken into account as income.

* * * * *

(13) The transferor's unamortized policy acquisition expenses or positive or negative capitalization requirements on its specified insurance contracts.

(14) The special loss discount account, provided, however, that the acquiring corporation will succeed to the special loss

discount account only to the extent that it is attributable to the portion of the transferor's insurance business acquired by the acquiring corporation in the section 381 transaction.

Par. 8. Section 1.1060–1 is amended by:

1. Revising paragraph (a)(2).

2. Adding entries in paragraph (a)(3) in the outline of topics for paragraphs (b)(9) and (c)(5).

3. Adding new paragraphs (b)(9) and (c)(5).

The revision and addition read as follows:

§ 1.1060–1 Special allocation rules for certain asset acquisitions.

(a) * * *

(2) *Effective dates*. In general, the provisions of this section apply to any asset acquisition occurring after March 15, 2001. However, paragraphs (b)(9) and (c)(5) of this section apply only to applicable asset acquisitions occurring on or after the date they are filed as final regulations with the **Federal Register**. For rules applicable to asset acquisitions on or before March 15, 2001, see § 1.1060–1T in effect prior to March 16, 2001 (see 26 CFR part 1 revised April 1, 2000).

(3) * * *

* * * * *

(b) * * *

(9) Insurance business.

(c) * * *

(5) Insurance business.

* * * * *

(b) * * *

(9) *Insurance business*. The mere reinsurance of insurance contracts by an insurance company is not an applicable asset acquisition, even if it enables the reinsurer to establish a customer relationship with the owners of the reinsured contracts. However, a transfer of an insurance business is an applicable asset acquisition if the purchaser acquires significant business assets, in addition to insurance contracts, to which goodwill and going concern value could attach. For rules regarding the treatment of an applicable asset acquisition of an insurance business, see paragraph (c)(5) of this section.

(c) * * *

(5) *Insurance business*. If the trade or business transferred is an insurance business, the rules of this paragraph (c) are modified by the principles of § 1.338–11(a) through (d). However, in transactions governed by section 1060, such principles apply even if the transfer of the trade or business is effected in whole or in part through indemnity reinsurance rather than assumption reinsurance, and, with respect to the insurer or reinsurer, an insurance contract (including an annuity or reinsurance contract) is a Class VI asset regardless of whether it is a section 197 intangible. In addition, the principles of § 1.338–11(e) through (g) apply if the transfer occurs in connection with the complete liquidation of the transferor.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 7, 2002, 8:45 a.m., and published in the issue of the Federal Register for March 8, 2002, 67 F.R. 10640)

Foundations Status of Certain Organizations

Announcement 2002–32

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Academy of Architecture Arts & Sciences, Beverly Hills, CA
Aleh-The Society for the Advancement of Science, Inc., Beverly Hills, CA
Alliance for the Advancement of Peoples of African Descent, New Rochelle, NY
Alliance Foundation, Playa Del Ray, CA
Ama Deum, Sherman Oaks, CA
American Coalition of Kidney Patients, Inc., La Puente, CA
American Foundation Against Cruelty to Equines Aface, Malibu, CA
American Friends of Chilean Healthcare, San Francisco, CA
American Mushroom Institute Community Awareness Scholarship, Avondale, PA
Anthroposophical Arts Council of Vermont, Shelburne, VT
Asian American Physicians Association, Rolling Hills Est, CA
Barbour County Rescue Mission, Inc., Clayton, AL
Benedicto Pimentel Verceles, Lomita, CA
Bolo Productions, Inc., Lancaster, CA
Cameron Silver Foundation, Los Angeles, CA
Center for Arts Science and Technology, Hacienda Heights, CA
Center for Informed Politics, Palo Alto, CA
Center for Peace and Unity, San Francisco, CA
Central Synagogue Preservation, Inc., New York, NY
Chicago Association of Resident Management Corporation, Chicago, IL
Christmas in April-Calcasieu Area, Inc., Sulphur, LA
Coalition of Asian Pacifics in Entertainment Foundation, Inc., West Hollywood, CA
Community Services Operation Need Voice, Sacramento, CA
Corporation for Better Housing, Glendale, CA
Cutler Non-Profit Housing Corp., Winter Park, FL
C.W.E., Inc., Charlotte, NC
Danzarte-Centro De Danza Y Arte Folkloricos Del Sudoeste, Inc., Tucson, AZ
D.C. Outfitters, Inc., Greenbelt, MD
Diamond Head Studios, Inc., Honolulu, HI
Eagle-Pleasant View PTO, Inc., Zionsville, IN

Educational Development Network, Inc., Riverside, CA
Elim Restoration Center, Oak Park, MI
Energy for the Future, Sacramento, CA
Escondido Athletic Booster Foundation, Escondido, CA
Esther Program, Pasadena, CA
Eye Birth Defects Research Foundation, Inc., Los Angeles, CA
Faith Housing Corporation, Los Angeles, CA
Family Resource Foundation, Inc., Palmdale, CA
Florida Criminal Justice Executive Institute Association, Inc., Cudjoe Key, FL
Florida Dance Conservatory Ballet Co., Inc., Lake Park, FL
Foundation for Nicaraguan Seminarians, Orange, CA
Foundation for the Advancement of Manufacturing Education, Fullerton, CA
Friars Point Youth Awareness Program, Friars Point, MS
Friends of Adult Literacy Services, Inc., Santee, CA
Friends of Education, Inc., New York, NY
Golden West Opera Theater, Los Angeles, CA
Great St. Anthony Red Sea Foundation, Temple City, CA
Green Star Kauai, Lihue, HI
Gym-Rhythmics, Inc., Cicero, NY
Hana Laulima Lahui O Kau, Naalehu, HI
Hawaii Recreation and Park Association, Honolulu, HI
Helkeinu Foundation, Beverly Hills, CA
Helping Friend, Inc., Compton, CA
High Desert Natural History Preserve 1949015, Agua Dulce, CA
His Image Ministries, Woodland Hills, CA
Homeaid America, Inc., Calabasas, CA
In Choro Novo, Inc., Roslindale, MA
Indigo Ink the St. Louis Association of African American Writers, St. Louis, MO
Institute of Spiritual Education and Evolution, Solvang, CA
Institute of Unification Strategy in US, Los Angeles, CA
Israel Environmental Fund, Topanga, CA
Israeli Culture Center of Westchester, Inc., Briarcliff Manor, NY
J. Paul Memorial Foundation, Tracy, CA
Jehovah Shammah World Ministries, Kihei, HI
Jesus Video Project of San Antonio, Inc., San Antonio, TX
JGT Foundation, Inc., Oakland, CA
Kahi Hoomana, Paia, HI
Kansas City Childrens Chorus, Kansas City, MO
Koa Youth Crime Prevention Association, Los Angeles, CA
KOL Sephardic Choir, Studio City, CA
Koreatown and West Adams Public Safety Association, Los Angeles, CA
La Palabra En Cada Hogar, Costa Mesa, CA
Lakhdar Barouche Foundation, Inc., New York, NY
Lancer Water Polo, La Habra Heights, CA
Lao Senior Association Incorporation, Richmond, CA
Latino Leadership Council of San Mateo County, San Mateo, CA
Latino Theater Company, Los Angeles, CA
Leadership Plano Alumni Association, Plano, TX
Liberty Singers, Inc., Lake Suzy, FL
Los Angeles Citizens Crime Commission, Hollywood, CA
Love in the Name of Christ of Hawaii, Holualoa, HI
Love of People Clinic LOPC, Inc., Grand Coteau, LA
Marcus Robertson Childrens Foundation, Nashville, TN
Mark E. King Medical Research Foundation, La Verne, CA
McAns City Link, Inc., Decatur, GA
Methadone as a Legitimate Treatment Alternative, Marysville, CA
Mike Kollie Foundation for Children & the Needy, Inc., West Haven, CT
Mililani In-Line Hockey Association, Mililani, HI
Ministry Wives Network International, Inc., Delray Beach, FL
Minority Professional Golf Development Association, Chicago, IL
Missy Foundation, Santa Clarita, CA
Nagano 98, Mililani, HI
National Black Presbyterian Caucus, Inc., Hillside, NJ
Network for International Economic Development, Midland, TX
New Beginnings Unlimited, Seattle, CA
New Citizen Institute, Inc., Los Angeles, CA
North of Market Neighborhood Improvement Corporation, San Francisco, CA
North Philadelphia Housing Development Corporation, Philadelphia, PA
North Pittsburgh Youth Hockey Association, Baden, PA
Oakland Cares, Oakland, CA
OC and Spectrum Disorders Association, Encino, CA
One in a Million United as Brothers, Blue Island, IL
Pacific Access Housing Associates, Pasadena, CA
Palms by the Stream Community Farm of Sylmar, Inc., Sylmar, CA
Papa Foundation, Evanston, IL
Parents University of Wyandotte County, Inc., Kansas City, KS
Pasadena Grace Community Development Association, Pasadena, CA
Pearl Harbor Performing Arts Association, Pearl Harbor, HI
People for Community Development Project, Inc., Los Angeles, CA
Pershing Park Housing Opportunity Corporation, Memphis, TN
Polk Youth Hockey Association, Inc., Lakeland, FL
Positive Force Athletic Club, Incorporated, Kailua Kona, HI
Precious Little Ones, Oakland, CA
Preserve Sight Mississippi, Jackson, MS
Project Heritage, N. Hollywood, CA
Project Worc, Inc., Suttenberg, NJ
Quality Forum, Inc., Los Angeles, CA
Racine County Hockey Association, Racine, WI
Rancho Vista Community Housing Association, Chula Vista, CA
Recovery Housing for the Benefit of the Community, Inc., Lakeworth, FL
Redwood City Police Activity League, Redwood City, CA
Restoring Hope Center, Inc., Fort Worth, TX
Rhema Rescue Mission, Jasper, AL
Rotary Club of Pacific Palisades Foundation, Pacific Palisades, CA
Saint Lucie County Agape Senior Citizen Recreational Center, Fort Pierce, FL
Sam Houston High School Band Booster Club, Inc., Arlington, TX
Samoa Hawaii Benefit Foundation, Honolulu, HI

Samsons Boxing Gym, Inc., Medina, OH
Save our Services Coalition, Inc., Los Angeles, CA
Scott John Stevenson Judeo-Christian Maritime Foundation, Palo Verdes, CA
Scott Ministries International, Redondo Beach, CA
Self Motivated Community Peoples Village Center, Inc., Baltimore, MD
Sherali Fazal Visram Memorial Foundation, Inc., Binghamton, NY
Signature Exploratory Theatre and Arts, Inc., Wichita, KS
South Central Kansas Association of Teachers of Mathematics, Wichita, KS
Southern California Resident Controlled Housing Association, Los Angeles, CA
Spiritual Emotional Intensive Care, Incorporated, Los Angeles, CA
Sponsorlink, Northridge, CA
Steeles Reeducation Centers, Inc., Oakland, CA
Stepping Stone to Recovery Foundation, Los Angeles, CA
Stream of Praise Music Ministries, El Monte, CA
Street Childrens Relief, Inc., Diamond Bar, CA
Striving to Empower People Successfully, Compton, CA
Supports for Abandoned Children and Elders Foundation, Los Angeles, CA
Survival Support Group, Glendale, CA
Teen Resources, Inc., Colorado Springs, CO
Telacu Housing-Monterey Park, Inc., Los Angeles, CA
Tender Loving Care Providers, Inc., Hayward, CA
TGC Team Booster Club, Hattiesburg, MS
Theatre on the Verge, Inc., Minneapolis, MN
Tijay Renee Crisis Center, Los Angeles, CA
Todays Fresh Start, Los Angeles, CA
Tomball Cougar Pride Band Booster Club, Inc., Tomball, TX
Top Five Percent Club, Honolulu, HI
Touching Hands of Life, Los Angeles, CA
Trenton Womens Center, Inc., Sommerset, NJ
Tri-City Youth Hockey Association, Inc., Holyoke, MA
T'shuvah, Inc., Los Angeles, CA
United Church Satellite Network, Santa Monica, CA
US-Japan Cultural Network, Torrance, CA
Visual Art League, Lewisville, TX
Voluntary Bar Association of Culver City and Marina Del Ray, Culver City, CA
Volunteer Refugee Aid International, Los Angeles, CA
Wake Our World Foundation, Chatsworth, CA
Welcome Wagon Club of Sebastian Florida, Sebastian, FL
West Texas Earth Resources Institute, Midland, TX
Wildlife History Foundation, Sacramento, CA
World Awareness Voyages, Honolulu, HI
World Maritime Ministries, Inc., Platteville, WI
YMCA of North Oakland Foundation, Inc., Rochester, NY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)–7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Civil Cause of Action for Certain Unauthorized Collection Actions

Announcement 2002–33

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking.

SUMMARY: This document withdraws the notice of proposed rulemaking (REG–251502–96, 1998–1 C.B. 621) relating to Internal Revenue Code section 7433 that was published in the **Federal Register** on Wednesday, December 31, 1997. The proposed regulations implemented provisions of the Taxpayer Bill of Rights 2 (TBOR2). TBOR2 raised the cap on damages under section 7433 and eliminated the jurisdictional prerequisite requiring a taxpayer to exhaust administrative remedies before filing a civil damage action.

FOR FURTHER INFORMATION CONTACT: Kevin Connelly, 202–622–3630 (not a toll-free number).

SUPPLEMENTAL INFORMATION:

Background

On Wednesday, December 31, 1997, the IRS issued proposed regulations titled Civil Cause of Action for Certain Unauthorized Collections Actions (62 FR 68242). Because the Internal Revenue Service Restructuring and Reform Act of 1998 substantially amended section 7433, including sections that TBOR2 had previously amended, we are withdrawing these proposed regulations (REG–251502–96). A new notice of proposed rulemaking (REG–107366–00, published elsewhere in this Bulletin) containing both the statutory provisions of TBOR2 and RRA1998 with respect to damage actions under section 7433, as well as section 7426, has been opened.

* * * * *

Withdrawal of Notice of Proposed Rulemaking

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published in the **Federal Register** on Wednesday, December 31, 1997 (62 FR 68242) is withdrawn.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on March 1, 2002, 8:45 a.m., and published in the issue of the Federal Register for March 4, 2002, 67 F.R. 9631)

Guidance Regarding Deduction and Capitalization of Expenditures; Correction

Announcement 2002–35

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to advance notice of proposed rulemaking.

SUMMARY: This document contains a correction to the advance notice of proposed rulemaking (Announcement 2002–9, 2002–7 I.R.B. 536) that was published in the **Federal Register** on Thursday, January 24, 2002 (67 FR 3461) that will clarify the application of section 263(a) of the Internal Revenue Code to expenditures incurred in acquiring, creating, or enhancing certain intangible assets or benefits.

DATES: This correction is effective January 24, 2002.

FOR FURTHER INFORMATION CONTACT: Andrew J. Keyso, (202) 927–9397 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

The advance notice of proposed rulemaking that is the subject of this correction is under section 263(a) of the Internal Revenue Code.

Need for Correction

As published, the advance notice of proposed rulemaking (REG–125638–01) contains an error which may prove to be misleading and is in need of clarification.

Correction of Publication

Accordingly, the publication of the advance notice of proposed rulemaking (REG–125638–01), which is the subject of FR Doc. 02–1678 is corrected as follows:

On page 3464, column 1, line 7, the language "*J.J. Case Company v. United States, 32*" is corrected to read "*J.I. Case Company v. United States, 32*."

Cynthia Grigsby,
Chief, Regulations Unit,
Associate Chief Counsel
(Income Tax and Accounting).

(Filed by the Office of the Federal Register on March 1, 2002, 8:00 a.m., and published in the issue of the Federal Register for March 4, 2002, 67 F.R. 9631)

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.—Intemal 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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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2001–27 through 2001–53 is in Internal Revenue Bulletin 2002–1, dated January 7, 2002.

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