Internal Revenue
bulletin

Bulletin No. 2003–6
February 10, 2003

HIGHLIGHTS OF THIS ISSUE

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

SPECIAL ANNOUNCEMENT

Announcement 2003–7, page 450.
This announcement provides transition rules for corporations and brokers required under sections 1.6043–4T and 1.6045–3T (T.D. 9022, 2002–48 I.R.B. 909) to file and furnish Form 1099–CAP with respect to acquisitions of control and substantial changes in corporate structure occurring in 2002. Affected corporations and brokers will not be required to file Form 1099–CAP for transactions occurring in 2002. In lieu of furnishing Form 1099–CAP to shareholders and actual stock owners, the corporations and brokers must furnish a letter containing specified language.

INCOME TAX

Rev. Rul. 2003–16, page 401.
Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the Code, tables set forth the rates for January 2003.

Rev. Rul. 2003–17, page 400.
Foreign life insurance companies. This ruling discusses whether a foreign life insurance company carrying on an insurance business in the United States determines the amount of income effectively connected with its U.S. business under section 842(a) of the Code based exclusively on the amount of income reported by the business on its NAIC statement.

T.D. 9029, page 403.
Final regulations under section 6050S of the Code provide guidance to eligible educational institutions on the information reporting requirements for qualified tuition and related expenses. The regulations under section 6011(e) require certain information returns to be filed on magnetic media.

Notice 2003–11, page 422.
Effective date of regulations under sections 6011 and 6112. This notice alerts the public that Treasury and the IRS will be providing some relief in regards to the effective dates of temporary regulations sections 1.6011–4T and 301.6112–1T that relate to tax shelter registrations.

Notice 2003–12, page 422.
Nonaccrual experience (NAE) method. This notice provides interim guidance to taxpayers seeking to change to, or from, a nonaccrual experience (NAE) method of accounting pending issuance of final regulations under section 448(d)(5) of the Code, as amended by the Job Creation and Worker Assistance Act of 2002. Rev. Proc. 2002–9 modified.

Rev. Proc. 2003–17, page 427.
Insurance companies; loss reserves; discounting unpaid losses. The loss payment patterns and discount factors are set forth for the 2002 determination year. These factors will be used to compute discounted unpaid losses under section 846 of the Code.

(Continued on the next page)

Finding Lists begin on page ii.

Department of the Treasury
Internal Revenue Service

INCOME TAX—Cont.

Rev. Proc. 2003–18, page 439.
Insurance companies; discounted estimated salvage recoverable. The salvage discount factors are set forth for 2002. These factors must be used to compute discounted estimated salvage recoverable under section 832 of the Code.

Rev. Proc. 2003–20, page 445.
Inventories; lower of cost or market; vehicle parts cores. This procedure provides a safe harbor method of accounting for the valuation of a taxpayer's inventory of vehicle parts cores. The safe harbor method is available to remanufacturers and rebuilders of motor vehicle parts, as well as resellers of remanufactured and rebuilt motor vehicle parts, that use the lower of cost or market inventory valuation method to value their inventory of cores held for remanufacturing or sale. Automatic method change procedures are also provided for taxpayers wishing to change to the safe harbor method. Rev. Proc. 2002–9 modified and amplified.

Announcement 2003–7, page 450.
This announcement provides transition rules for corporations and brokers required under sections 1.6043–4T and 1.6045–3T (T.D. 9022, 2002–48 I.R.B. 909) to file and furnish Form 1099–CAP with respect to acquisitions of control and substantial changes in corporate structure occurring in 2002. Affected corporations and brokers will not be required to file Form 1099–CAP for transactions occurring in 2002. In lieu of furnishing Form 1099–CAP to shareholders and actual stock owners, the corporations and brokers must furnish a letter containing specified language.

EMPLOYEE PLANS

Announcement 2003–6, page 450.
This announcement contains a change in the hearing date for REG–209500–86 and REG–164464–02, 2003–2 I.R.B. 262, from April 10, 2003, to April 9, 2003. These regulations provide rules regarding the requirements that accruals or allocations under certain retirement plans not cease or be reduced because of the attainment of any age.

EXEMPT ORGANIZATIONS

Rev. Proc. 2003–21, page 448.
This procedure allows for relief for certain exempt organizations (other than private foundations) organized in U.S. possessions from the requirement of filing an annual information return on Form 990, *Return of Organization Exempt From Income Tax*. The procedure applies to U.S. possession organizations described in section 501(c)(3) of the Code (other than private foundations) that normally do not have more than $25,000 in annual gross receipts from sources within the United States and have no significant activity in the United States. Rev. Proc. 83–23 supplemented.

ADMINISTRATIVE

T.D. 9027, page 413.
Final regulations under section 6331 of the Code provide for the prohibition of levy while an installment agreement is pending with the Secretary, while an installment agreement is in effect, and following the rejection or termination of an installment agreement. The regulations clarify when levy is prohibited and the effect of that prohibition on the statute of limitations for collection. They also provide that the IRS may not refer a case to the Department of Justice for the commencement of a proceeding in court for the collection of a tax included in a proposed or active installment agreement while levy is prohibited by this section.

T.D. 9028, page 415.
Final regulations under section 7602(c) of the Code describe the rules and exceptions which prohibit IRS employees from contacting any person other than the taxpayer for determination or collection of the taxpayer's liability.

Notice 2003–11, page 422.
Effective date of regulations under sections 6011 and 6112. This notice alerts the public that Treasury and the IRS will be providing some relief in regards to the effective dates of temporary regulations sections 1.6011–4T and 301.6112–1T that relate to tax shelter registrations.

Announcement 2003–8, page 451.
This document contains corrections to final regulations (T.D. 9002, 2002–29 I.R.B. 120) relating to the agent for subsidiaries of an affiliated group that files a consolidated return.

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 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A–1: Uniform capitalization of costs.

A safe harbor method of accounting for the valuation of motor vehicle parts "cores" is provided to remanufacturers and rebuilders of motor vehicle parts, as well as resellers of remanufactured and rebuilt motor vehicle parts, that use the lower of cost or market method of accounting. See Rev. Proc. 2003–20, page 445.

Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

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

The adjusted applicable federal long-term rate is set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446–1: General rule for methods of accounting.

Procedures are provided for certain taxpayers using the lower of cost or market method of accounting to request automatic consent of the Commissioner to change to a safe harbor method of accounting for the valuation of motor vehicle parts "cores." See Rev. Proc. 2003–20, page 445.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 471.—General Rule for Inventories

26 CFR 1.471–2: Valuation of Inventories.

A safe harbor method of accounting for the valuation of motor vehicle parts "cores" is provided to remanufacturers and rebuilders of motor vehicle parts, as well as resellers of remanufactured and rebuilt motor vehicle parts, that use the lower of cost or market method of accounting. See Rev. Proc. 2003–20, page 445.

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

26 CFR 1.472–2: Requirements incident to adoption and use of LIFO inventory method.

Procedures are provided for certain taxpayers to concurrently change from their cost method to the lower of cost or market method in conjuction with a change to a safe harbor method of accounting for the valuation of motor vehicle parts "cores." See Rev. Proc. 2003–20, page 445.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481–1: Adjustments in general.

Procedures are provided for certain taxpayers using the lower of cost or market method of accounting to request automatic consent of the Commissioner to change to a safe harbor method of accounting for the valuation of motor vehicle parts "cores." See Rev. Proc. 2003–20, page 445.

Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2002–16, page 401.

Section 832.—Insurance Company Taxable Income

26 CFR 1.832–4: Gross income.

The salvage discount factors are set forth for 2002. These factors must be used to compute discounted estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2003–18, page 439.

Section 842.—Foreign Companies Carrying on Insurance Business

26 CFR 1.864–4(c): U.S. source income effectively connected with U.S. business.
(Also section 864(c).)

Rev. Rul. 2003–17

ISSUE

Whether a foreign life insurance company carrying on an insurance business in the United States determines the amount of income effectively connected with its U.S. business under section 842(a) of the Internal Revenue Code (the "Code") based exclusively on the amount of income reported by the business on the National Association of Insurance Commissioner's annual statement ("NAIC statement") filed with the state insurance commissioner.

FACTS

FC, a Country X corporation, is a foreign life insurance company that issues life insurance, annuity, and other insurance contracts in Country X and the United States. FC's activities in connection with its insurance business constitute the conduct of a trade or business within the United States (the "U.S. branch"). FC conducts its insurance activities in State Y. Under the law of State Y, FC is required to maintain trusteed assets and deposits in the United States sufficient to satisfy all potential claims of its U.S. policyholders. FC also maintains in the United States and uses in its U.S. business non-trusteed assets consisting of bonds, stocks, and short-term investments which are managed by individuals located in the United States and accounted for on the books of the U.S. branch.

FC is required to file a NAIC statement with State Y. Generally, this NAIC statement is intended to permit the insurance regulatory body to determine whether a foreign insurance company has sufficient assets to satisfy all potential claims of its U.S. policyholders. While the trusteed assets held by FC (and corresponding income) are required to be included on the NAIC statement, the non-trusteed assets (and corresponding income) are not reflected in the NAIC statement.

LAW AND ANALYSIS

Section 842(a) provides that if a foreign company carrying on an insurance business within the United States would qualify under part I of subchapter L for the taxable year if (without regard to income not effectively connected with the conduct of any trade or business within the United States) it were a domestic corporation, such company shall be taxable under such part on its income effectively connected with its conduct of any trade or business within the United States. Section 842(a) further provides that with respect to the remainder of income which is from sources within the United States, such a foreign company shall be taxable as provided in section 881.

Section 864(c)(1) provides that in the case of a foreign corporation engaged in a trade or business within the United States during the taxable year, the rules set forth in section 864(c)(2), (3), (4), (6), and (7) shall apply in determining the income, gain or loss which shall be treated as effectively connected with the conduct of a trade or business within the United States ("ECI"). Section 864(c)(2) generally provides rules for determining whether certain fixed or determinable, annual or periodical income from sources within the United States or gain or loss from sources within the United States from sale or exchange of capital assets is ECI. In making this determination, the factors taken into account include whether (a) the income, gain or loss is derived from assets used in or held for use in the conduct of such trade or business, or (b) the activities of such trade or business were a material factor in the realization of such income, gain or loss. Sec. 864(c)(2). Treas. Reg. § 1.864–4(c)(2) sets forth factors to be considered in determining whether an asset is used in or held for use in the conduct of a U.S. trade or business for purposes of section 864(c)(2). Under the regulations, an asset is ordinarily treated as used in, or held for use in, the conduct of a U.S. trade or business if the asset is: (a) held for the principal purpose of promoting the present conduct of the U.S. trade or business; (b) acquired and held in the ordinary course of the U.S. trade or business; or (c) otherwise held in a direct relationship to the U.S. trade or business. Treas. Reg. § 1.864–4(c)(2)(ii). In determining whether an asset is held in a direct relationship to the U.S. trade or business, principal consideration is given to whether the asset is held to meet the present needs of the business. Treas. Reg. § 1.864–4(c)(2)(iv)(a). An asset shall be considered as needed in the U.S. business if, for example, the asset is held to meet the operating expenses of that business, but not if held for future diversification into a new trade or business, expansion of trade or business activities outside the United States, or future business contingencies. *Id*. The regulations provide for a presumption of a direct relationship where: (1) the asset was acquired with funds generated by the trade or business; (2) the income from the asset is retained or reinvested in the trade or business; and (3) personnel present in the United States and actively involved in the conduct of that trade or business exercise significant management and control over the investment of the asset. Treas. Reg. § 1.864–4(c)(2)(iv)(b).

In determining whether an asset is used in or held for use in the conduct of a U.S. trade or business or whether the activities of the trade or business were a material factor in the realization of the income, gain or loss, due regard is given to whether or not such asset, or income, gain or loss was accounted for through the trade or business. Sec. 864(c)(2); Treas. Reg. § 1.864–4(c)(4). However, this accounting test shall not by itself be controlling. Treas. Reg. § 1.864–4(c)(4).

All other income, gain or loss from sources within the United States is treated as ECI. Sec. 864(c)(3). Section 864(c)(4)(C) provides that in the case of a foreign insurance company any income from sources without the U.S. which is attributable to its U.S. business is treated as ECI. *See also*

Treas. Reg. § 1.864–5(c) (In determining its life insurance company taxable income from its U.S. business, the foreign corporation shall include all of its items of income from sources without the United States which would appropriately be taken into account in determining the life insurance company taxable income of a domestic corporation).

The Report of the House Committee on Ways & Means (the "House Report") provides:

> Your committee believes that foreign insurance companies—life insurance companies and other insurance companies, including both mutual and stock companies—should, in general, be taxed on their investment income in the same manner as other foreign corporations. For this reason, the bill provides that a foreign insurance corporation carrying on an insurance business within the United States is to be taxable in the same manner as domestic companies carrying on a similar business with respect to its income which is effectively connected with the conduct of a trade or business within the United States. . . . For purposes of determining whether or not income of a foreign life insurance company is effectively connected with the conduct of its U.S. life insurance business, the annual statement of its U.S. business on the form approved by the National Association of Insurance Commissioners will *usually* be followed. It is noted that *all* the income effectively connected with the foreign life insurance company's U.S. life insurance business, from whatever source derived, comes within the ambit of this provision. This is a continuation of present law which subjects to U.S. tax all the income attributable to the U.S. life insurance business from whatever source derived.

H.R. Rep. No. 1450, 89th Cong., 2d Sess. 31, 32 (1966) (emphasis added); S. Rep. No. 1707, 89th Cong., 2d Sess. 38 (1966) (same).

The House Report also states that "[i]n determining for purposes of subchapter L whether a foreign corporation is carrying on an insurance business in the United States, and whether income is effectively connected with the conduct of a trade or business within the United States, section 864(b) and (c), as added by section 2(d) of the bill, shall apply." House Report at 94. Thus, the legislative history confirms that a foreign life insurance company applies the standards set forth in section 864(c) to determine the amount of its effectively connected income.

Accordingly, under section 842(a) and consistent with the accompanying legislative history, foreign insurance companies are taxed on their ECI. Section 864(c) does not contain specific rules for foreign insurance companies other than in section 864(c)(4)(C). Similarly, no specific rules were provided for foreign insurance companies in regulations issued under section 864 other than Treas. Reg. § 1.864–5(c). Neither section 842 or 864 provides that an insurance company determines its ECI solely based on its NAIC statements.

While the legislative history states that NAIC statements will *usually* be followed, the legislative history makes clear that section 864(c) shall determine whether income is ECI. Accordingly, income on assets such as the non-trusteed assets of FC are not necessarily excluded from ECI merely because they do not appear on the NAIC statement.

Section 864(c)(2) and the regulations thereunder provide that due regard shall be given to whether or not an asset, income, gain, or loss was accounted for through the U.S. trade or business. Accordingly, in determining if the income, gain or loss from the non-trusteed assets is ECI, due regard must be given to the fact that FC has accounted for such assets on the books of the U.S. branch.

HOLDING(S)

FC is taxable on any income effectively connected with its U.S. trade or business. For this purpose, ECI is determined under section 864(c) and the accompanying regulations. While due regard shall be given to the NAIC statement, such statement shall not be determinative of the amount of ECI. Further, due regard also must be given to the fact that FC has accounted for the non-trusteed assets on the books of the U.S. branch.

DRAFTING INFORMATION

The principal author of this revenue ruling is Sheila Ramaswamy of the Office of Associate Chief Counsel (International). For further information regarding this revenue ruling, contact Ms. Ramaswamy at (202) 622–3870.

Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

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26 CFR 1.846–1: Application of discount factors.

The loss payment patterns and discount factors are set forth for the 2002 determination year. These factors will be used to compute discounted unpaid losses under section 846 of the Code. See Rev. Proc. 2003–17, page 427.

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26 CFR 1.846–1: Application of discount factors.

The salvage discount factors are set forth for 2002. These factors must be used to compute discounted estimated salvage recoverable for purposes of section 832 of the Code. See Rev. Proc. 2003–18, page 439.

Section 864(c).—Definitions and Special Rules - Effectively Connected Income, etc.

Whether a foreign life insurance company carrying on an insurance business in the United States determines the amount of income effectively connected with its U.S. business under section 842(a) of the Code based exclusively on the amount of income reported by the business on its NAIC statement.

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

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

Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate. For purposes of sections 382, 1274, 1288, and other sections of the code, tables set forth the rates for January 2003.

Rev. Rul. 2003–16

This revenue ruling provides various prescribed rates for federal income tax pur-

poses for February 2003 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2003–16 TABLE 1

Applicable Federal Rates (AFR) for February 2003

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-Term				
AFR	1.65%	1.64%	1.64%	1.63%
110% AFR	1.81%	1.80%	1.80%	1.79%
120% AFR	1.98%	1.97%	1.97%	1.96%
130% AFR	2.14%	2.13%	2.12%	2.12%
Mid-Term				
AFR	3.27%	3.24%	3.23%	3.22%
110% AFR	3.59%	3.56%	3.54%	3.53%
120% AFR	3.93%	3.89%	3.87%	3.86%
130% AFR	4.25%	4.21%	4.19%	4.17%
150% AFR	4.92%	4.86%	4.83%	4.81%
175% AFR	5.75%	5.67%	5.63%	5.60%
Long-Term				
AFR	4.85%	4.79%	4.76%	4.74%
110% AFR	5.34%	5.27%	5.24%	5.21%
120% AFR	5.83%	5.75%	5.71%	5.68%
130% AFR	6.33%	6.23%	6.18%	6.15%

REV. RUL. 2003–16 TABLE 2

Adjusted AFR for February 2003

Period for Compounding

	Annual	*Semiannual*	*Quarterly*	*Monthly*
Short-term adjusted AFR	1.40%	1.40%	1.40%	1.40%
Mid-term adjusted AFR	2.84%	2.82%	2.81%	2.80%
Long-term adjusted AFR	4.56%	4.51%	4.48%	4.47%

REV. RUL. 2003–16 TABLE 3	
Rates Under Section 382 for February 2003	
Adjusted federal long-term rate for the current month	4.56%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.65%

REV. RUL. 2003–16 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for February 2003	
Appropriate percentage for the 70% present value low-income housing credit	7.94%
Appropriate percentage for the 30% present value low-income housing credit	3.40%

REV. RUL. 2003–16 TABLE 5	
Rate Under Section 7520 for February 2003	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.0%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 6050S.— Returns Relating to Higher Education Tuition and Related Expenses

26 CFR 1.6050S–1: Information reporting for qualified tuition and related expenses.

T.D. 9029

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1, 301, and 602

Information Reporting for Qualified Tuition and Related Expenses; Magnetic Media Filing Requirements for Information Returns

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the information reporting requirements for qualified tuition and related expenses under section 6050S of the Internal Revenue Code, including rules prescribing when the required information returns must be filed on magnetic media. The final regulations reflect changes made to the law by the Taxpayer Relief Act of 1997 and the amendments made by the Internal Revenue Service Restructuring and Reform Act of 1998 and Public Law 107–131. These regulations provide guidance to eligible educational institutions that enroll any individual for any academic period. These regulations also provide guidance to insurers that make reimbursements or refunds of qualified tuition and related expenses.

DATES: *Effective Date:* These regulations are effective December 19, 2002.

Applicability Date: For dates of applicability, see § 1.6050S–1(f) and § 301.6011–2(g)(3).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Tonya Christianson, (202) 622–4910; and concerning the magnetic media filing specifications, waivers for filing on magnetic media, and extensions of time, contact the IRS, Martinsburg Computing Center, (304) 263–8700 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1678.

Responses to this collection of information are mandatory.

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

The estimated reporting burden for the reporting in these regulations is reflected on the burden for Form 1098–T.

Estimated total annual reporting burden for 2001 for Form 1098–T: 3,056,411 hours.

Estimated number of responses for 2001 for Form 1098–T as of November 22, 2002: 20,376,075.

Estimated average annual burden hours per response for 2001 for Form 1098–T: 9 minutes.

Comments concerning the accuracy of this burden and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, W:CAR:MP:FP:S, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) relating to the information reporting requirements for qualified tuition and related expenses under section 6050S of the Internal Revenue Code (Code) and amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to magnetic media reporting. The Taxpayer Relief Act of 1997 (Public Law 105–34 (111 Stat. 788) (TRA '97)) added section 6050S of the Code. Section 6050S was amended by the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105–206 (112 Stat. 685) (RRA '98)), and Public Law 107–131 (115 Stat. 2410). In general, section 6050S requires any eligible educational institution (institution) to file information returns and to furnish written information statements to assist taxpayers and the Internal Revenue Service (IRS) in determining the amount of qualified tuition and related expenses (qualified expenses) for which an education tax credit is allowable under section 25A (as well as other tax benefits for higher education expenses). See H.R. Conf. Rept. No. 599, 105th Cong., 2d Sess., pp. 319–320 (1998).

As provided by Public Law 107–131, for calendar years beginning after December 31, 2002, institutions may elect to report either the aggregate amount of payments received, or the aggregate amount billed, for qualified expenses during the calendar year with respect to individuals enrolled for any academic period. Institutions must report separately adjustments (*i.e.*, refunds of payments or reductions in charges) made during the calendar year to payments received, or amounts billed, for qualified expenses that were reported in a prior calendar year. In addition, institutions must report the aggregate amount of scholarships or grants received for an individual's costs of attendance that the institution administered and processed during the calendar year. Institutions must report separately adjustments (*i.e.*, refunds or reductions) made during the calendar year to scholarships that were reported in a prior calendar year.

In addition, section 6050S requires any person engaged in a trade or business of making payments to any individual under an insurance agreement as reimbursements or refunds of qualified expenses (an insurer) to file information returns and to furnish written information statements.

A notice of proposed rulemaking under section 6050S (REG–105316–98, 2000–2 C.B. 98) was published in the **Federal Register** (65 FR 37728) on June 16, 2000 (the 2000 proposed regulations). The 2000 proposed regulations relating to the information reporting requirements for institutions and insurers were withdrawn and a new notice of proposed rulemaking (REG–161424–01, 2002–21 I.R.B. 1010) was published in the **Federal Register** (67 FR 20923) on April 29, 2002 (the 2002 proposed regulations). No request for a public hearing was received on the 2002 proposed regulations. The IRS received written and electronic comments responding to the 2002 notice of proposed rulemaking. After consideration of all the comments, the 2002 proposed regulations are adopted as amended by this Treasury decision. The revisions are discussed below.

Explanation of Provisions and Summary of Comments

1. *Information Reporting Relating to Qualified Tuition and Related Expenses*

A. *Required reporting and exceptions to reporting*

(i) Reporting Based on Academic Year vs. Calendar Year

One commentator to the 2002 proposed regulations requested that institutions be allowed to report financial data based on an academic year, and not based on a calendar year. Section 6050S requires institutions to report on a calendar year in order to assist taxpayers in calculating the education tax credit that is allowable for qualified expenses paid during a calendar year. Therefore, the final regulations do not adopt this recommendation.

(ii) Exception for Noncredit Courses

The 2002 proposed regulations provide an exception to reporting for any student who is enrolled during the calendar year only in courses for which no academic credit is offered. Several commentators to the 2002 proposed regulations requested that if a student is enrolled both in courses for which academic credit is offered (*e.g.*, courses in a postsecondary degree program) and courses for which no academic credit is offered (*e.g.*, courses in a continuing education program), institutions should be required to report only the courses for which academic credit is offered. The commentators suggested that the exception to reporting should be based on the category of courses, not the category of students. The commentators explained that institutions maintain separate databases for credit courses and noncredit courses and that it would create a substantial hardship if institutions were required to report for both credit courses and noncredit courses. In response to these comments, and because under section 25A and the regulations thereunder a student enrolled in a postsecondary degree program is not eligible to claim a Hope Scholarship Credit (and may not be eligible to claim a Lifetime Learning Credit) for noncredit courses, the final regulations adopt this recommendation. Accordingly, the final regulations provide that institutions are not required to report with respect to courses for which no aca-

demic credit is offered by the institution, even if the student is enrolled in a degree program.

(iii) No Exception for Small Amounts of Qualified Tuition and Related Expenses

One commentator to the 2002 proposed regulations requested that the regulations provide an exception to reporting for qualified expenses of $100 or less. The limited exceptions to required reporting are based on the fact that certain categories of students may not be eligible to claim the education tax credit and that certain payments may not be taken into account in calculating the amounts paid for qualified expenses for which an education tax credit is allowable. An exception to reporting for small amounts of qualified expenses has no relationship to whether an education tax credit is allowable for amounts paid for qualified expenses. Therefore, the final regulations do not adopt this recommendation.

(iv) Exception for Students Whose Qualified Expenses Are Covered by Formal Billing Arrangement

The 2002 proposed regulations provide an exception to reporting for any student whose qualified expenses are paid by the student's employer through a formal billing arrangement under which the employer's employees attend the institution, the institution bills only the employer, and the institution does not maintain a separate account for any employee/student. Several commentators to the 2002 proposed regulations requested that this exception be expanded to include formal billing arrangements between institutions and other third party payors, such as the Veterans' Administration, U.S. Armed Forces, and other governmental and private organizations.

Under section 25A and the regulations thereunder, a taxpayer cannot claim the education tax credit for educational expenses paid with amounts that are excludable from gross income. Educational expenses paid through a formal billing arrangement between an institution and a governmental entity, such as the Veterans' Administration, often are excludable from the gross income of the individual student. Therefore, the final regulations expand the exception to cover formal billing arrangements between an institution and a governmental entity under which the institution bills only the governmental entity and does not maintain a separate account with respect to any individual student. In addition, the final regulations authorize the Commissioner to designate additional types of formal billing arrangements for which no reporting will be required. It is anticipated that any additional formal billing arrangements designated by the Commissioner will be limited to situations in which the individual students generally would not be eligible to claim an education tax credit with respect to the payments made by the institutional third party payor.

(v) Family Educational Rights and Privacy Act and Optional Reporting

The U.S. Department of Education has previously determined that reporting under section 6050S does not violate the Family Educational Rights and Privacy Act (FERPA) (20 U.S.C. section 1232g). Several commentators to the 2002 proposed regulations requested clarification as to whether an institution that chooses to report on all students under section 6050S, even if the regulations provide an exception to required reporting, would violate FERPA. After the 2002 proposed regulations were issued, the Treasury Department asked the Department of Education to consider whether its earlier determination would extend to an institution that chooses to report on students otherwise covered by an exception to required reporting. The Department of Education has recently determined that an institution will not violate FERPA if it chooses to report information on all students in accordance with section 6050S, even if the regulations provide an exception to required reporting.

B. *Required information for institutions*

(i) Reporting Amounts Billed in One Year That Relate to an Academic Period that Begins During the First Three Months of the Next Year

Several commentators to the 2002 proposed regulations requested that the final regulations eliminate the requirement that institutions indicate that amounts reported as billed in one calendar year relate to qualified expenses for an academic period that begins during the first three months of the next calendar year. The commentators explained that most institutions bill late in one calendar year for the qualified expenses that relate to an academic period that begins in the first three months of the next calendar year. The commentators questioned the usefulness of this information.

Under section 25A and the regulations thereunder, the education tax credit is allowable only for amounts actually paid during the calendar year for an academic period that begins during the same calendar year or during the first three months of the next calendar year. Therefore, there may be situations where an institution reports amounts billed for qualified expenses in one calendar year that relate to an academic period that begins during the first three months of the next calendar year, and the taxpayer pays the qualified expenses in the next calendar year. In this situation, the taxpayer and the IRS should be advised that the amounts reported as billed during a calendar year may not be amounts for which the taxpayer may claim the education tax credit for that year. Therefore, the final regulations do not adopt this recommendation.

(ii) Reporting Requirements for Increases to Charges for Qualified Expenses and Grants Reported for a Prior Calendar Year

One commentator requested clarification as to whether the 2002 proposed regulations purposely did not require separate reporting for increases to charges for qualified expenses and grants reported by the institution for a prior calendar year. The amendments to section 6050S by Public Law 107–131 require institutions to report the aggregate amount of charges for qualified expenses and the aggregate amount of grants administered and processed during the calendar year. These aggregate amounts would include any increases in charges for qualified expenses that relate to a prior year and any increases in grants that relate to a prior year. Therefore, no separate reporting is required for increases to charges for qualified expenses and grants that relate to a prior year.

(iii) Information Contact

The 2002 proposed regulations require institutions and insurers to include on the information statement furnished to the student the name, address, and phone number of the office or department within the institution or insurer that is the information contact. Several commentators requested that the regulations be revised to allow third party service providers that file information returns on behalf of the institutions or the insurers, as well as a third party call centers, to be designated as the information contact. Consistent with section 6050S(d)(1), the final regulations require institutions and insurers to include the

name, address, and phone number of the information contact of the person required to file the information return. This provision does not preclude any institution or insurer that is required to file an information return from including, in addition to its own name, address, and phone number, the name, address, and phone number of a third party service provider.

C. *Information reporting penalties*

(i) Filing Information Returns with Missing TINs

Several commentators to the 2002 proposed regulations requested that institutions not be required to file information returns and to furnish information statements for students who refuse to provide their TINs. Information returns and information statements with missing TINs are useful to both the IRS and the taxpayer in verifying the amount of any allowable education tax credit (as well as other tax benefits for higher education expenses). Therefore, the final regulations do not adopt this recommendation.

2. *Requirement to File Information Returns on Magnetic Media*

The final regulations amend the regulations under section 6011(e) to require institutions and insurers who are required to file 250 or more Forms 1098–T, *Tuition Statement,* to file on magnetic media.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. A final regulatory flexibility analysis has been prepared for the collection of information in this Treasury decision. This analysis is set forth in this preamble under the heading "Final Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Final Regulatory Flexibility Analysis

The collection of information contained in § 1.6050S–1 is needed to assist the IRS and taxpayers in determining the amount of any education tax credit allowable under section 25A (as well as other tax benefits for higher education expenses). The objectives of these final regulations are to provide uniform, practicable, and administrable rules under section 6050S. The types of small entities to which the regulations may apply are small eligible educational institutions (such as colleges and universities) and certain insurers who reimburse educational expenses.

There are no known Federal rules that duplicate, overlap, or conflict with these regulations. The regulations are considered to have the least economic impact on small entities of all alternatives considered.

Moreover, the regulations requiring filing Forms 1098–T on magnetic media impose no additional reporting or record keeping and only prescribe the method of filing information returns that are already required to be filed. Further, these regulations are consistent with the statutory requirement that an institution or insurer is not required to file Forms 1098–T on magnetic media unless required to file at least 250 or more returns during the year. Finally, the economic impact caused by requiring Forms 1098–T on magnetic media should be minimal because most institutions' or insurers' operations are computerized. Even if their operations are not computerized, the incremental cost of magnetic media reporting should be minimal in most cases because of the availability of computer service bureaus. In addition, the existing regulations under section 6011(e) provide that the IRS may waive the magnetic media filing requirements on a showing of hardship. The waiver authority will be exercised so as not to unduly burden institutions and insurers lacking both the necessary data processing facilities and access at a reasonable cost to computer service bureaus.

Drafting Information

The principal author of the regulations is Tonya Christianson, Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. However, other personnel from the IRS and the Treasury Department participated in the development of the regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1, 301, and 602 are amended as follows:

PART 1 — INCOME TAX

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 1.6050S–1 also issued under section 26 U.S.C. 6050S(g).* * *

Par. 2. Section 1.6050S–0 is amended by revising the introductory language and adding new entries for § 1.6050S–1 to read as follows:

§ 1.6050S–0 Table of contents

This section lists captions contained in §§ 1.6050S–1, 1.6050S–2T, 1.6050S–3, and 1.6050S–4T.

§ 1.6050S–1 Information reporting for qualified tuition and related expenses.

(a) Information reporting requirement.

(1) In general.

(2) Exceptions.

(i) No reporting by institutions or insurers for nonresident alien individuals.

(ii) No reporting by institutions for noncredit courses.

(A) In general.

(B) Academic credit defined.

(C) Example.

(iii) No reporting by institutions for individuals whose qualified tuition and related expenses are waived or are paid with scholarships.

(iv) No reporting by institutions for individuals whose qualified tuition and related expenses are covered by a formal billing arrangement.

(A) In general.

(B) Formal billing arrangement defined.

(b) Requirement to file return.

(1) In general.

(2) Information reporting requirements for institutions that elect to report payments received for qualified tuition and related expenses.

(i) In general.

(ii) Information included on return.

(iii) Reportable amount of payments received for qualified tuition and related expenses during calendar year determined.

(iv) Separate reporting of reimbursements or refunds of payments of quali-

fied tuition and related expenses that were reported for a prior calendar year.

(v) Payments received for qualified tuition and related expenses determined.

(vi) Reimbursements or refunds of payments for qualified tuition and related expenses determined.

(vii) Examples.

(3) Information reporting requirements for institutions that elect to report amounts billed for qualified tuition and related expenses.

(i) In general.

(ii) Information included on return.

(iii) Reportable amounts billed for qualified tuition and related expenses during calendar year determined.

(iv) Separate reporting of reductions made to amounts billed for qualified tuition and related expenses that were reported for a prior calendar year.

(v) Examples.

(4) Requirements for insurers.

(i) In general.

(ii) Information included on return.

(5) Time and place for filing return.

(i) In general.

(ii) Return for nonresident alien individual.

(iii) Extensions of time.

(6) Use of magnetic media.

(c) Requirement to furnish statement.

(1) In general.

(2) Time and manner for furnishing statement.

(i) In general.

(ii) Statement to nonresident alien individual.

(iii) Extensions of time.

(3) Copy of Form 1098–T.

(d) Special rules.

(1) Enrollment determined.

(2) Payments of qualified tuition and related expenses received or collected by one or more persons.

(i) In general.

(ii) Exception.

(3) Governmental units.

(e) Penalty provisions.

(1) Failure to file correct returns.

(2) Failure to furnish correct information statements.

(3) Waiver of penalties for failures to include a correct TIN.

(i) In general.

(ii) Acting in a responsible manner.

(iii) Manner of soliciting TIN.

(4) Failure to furnish TIN.

(f) Effective date.

* * * * *

Par. 3. Section 1.6050S–1 is added to read as follows:

§ 1.6050S–1 Information reporting for qualified tuition and related expenses.

(a) *Information reporting requirement* — (1) *In general.* Except as provided in paragraph (a)(2) of this section, any eligible educational institution (as defined in section 25A(f)(2) and the regulations thereunder) (an institution) that enrolls (as determined under paragraph (d)(1) of this section) any individual for any academic period (as defined in the regulations under section 25A), and any person that is engaged in a trade or business of making payments under an insurance arrangement as reimbursements or refunds (or other similar amounts) of qualified tuition and related expenses (as defined in section 25A(f)(1) and the regulations thereunder) (an insurer) must —

(i) File an information return, as described in paragraph (b) of this section, with the Internal Revenue Service (IRS) with respect to each individual described in paragraph (b) of this section; and

(ii) Furnish a statement, as described in paragraph (c) of this section, to each individual described in paragraph (c) of this section.

(2) *Exceptions* — (i) *No reporting by institution or insurer for nonresident alien individuals.* The information reporting requirements of this section do not apply with respect to any individual who is a nonresident alien (as defined in section 7701(b) and § 301.7701(b)–3 of this chapter) during the calendar year, unless the individual requests the institution or insurer to report. If a nonresident alien individual requests an institution or insurer to report, the institution or insurer must comply with the requirements of this section for the calendar year with respect to which the request is made.

(ii) *No reporting by institutions for noncredit courses* — (A) *In general.* The information reporting requirements of this section do not apply with respect to any course for which no academic credit is offered by the institution.

(B) *Academic credit defined. Academic credit* means credit offered by an institution for the completion of course work leading toward a post-secondary degree, certificate, or other recognized post-secondary educational credential.

(C) *Example.* The following example illustrates the rules of this paragraph (a)(2)(ii):

Example. Student A, a medical doctor, takes a course at University X's medical school. Student A takes the course to fulfill State Y's licensing requirement that medical doctors attend continuing medical education courses each year. Student A is not enrolled in a degree program at University X and takes the medical course through University X's continuing professional education division. University X does not offer credit toward a post-secondary degree on an academic transcript for the completion of the course but gives Student A a certificate of attendance upon completion. Under this paragraph (a)(2)(ii), University X is not subject to the information reporting requirements of section 6050S and this section for the medical education course taken by Student A.

(iii) *No reporting by institutions for individuals whose qualified tuition and related expenses are waived or are paid with scholarships.* The information reporting requirements of this section do not apply with respect to any individual whose qualified tuition and related expenses are waived in their entirety or are paid entirely with scholarships.

(iv) *No reporting by institutions for individuals whose qualified tuition and related expenses are covered by a formal billing arrangement* — (A) *In general.* The information reporting requirements of this section do not apply with respect to any individual whose qualified tuition and related expenses are covered by a formal billing arrangement as defined in paragraph (a)(2)(iv)(B) of this section.

(B) *Formal billing arrangement defined.* A *formal billing arrangement* means —

(*1*) An arrangement in which the institution bills only an employer for education furnished by the institution to an individual who is the employer's employee and does not maintain a separate financial account for that individual;

(*2*) An arrangement in which the institution bills only a governmental entity for education furnished by the institution to an individual and does not maintain a separate financial account for that individual; or

(*3*) Any other similar arrangement in which the institution bills only an institutional third party for education furnished to an individual and does not maintain a separate financial account for that individual, but only if designated as a formal billing arrangement by the Commissioner in pub-

lished guidance of general applicability or in guidance directed to participants in specific arrangements.

(b) *Requirement to file return* — (1) *In general.* Institutions may elect to report either the information described in paragraph (b)(2) of this section, or the information described in paragraph (b)(3) of this section. Once an institution elects to report under either paragraph (b)(2) or (3) of this section, the institution must use the same reporting method for all calendar years in which it is required to file returns, unless permission is granted to change reporting methods. Paragraph (b)(2) of this section requires institutions to report, among other information, the amount of payments received during the calendar year for qualified tuition and related expenses. Institutions must report separately adjustments made during the calendar year that relate to payments received for qualified tuition and related expenses that were reported for a prior calendar year. For purposes of paragraph (b)(2) of this section, an adjustment made to payments received means a reimbursement or refund. Paragraph (b)(3) requires institutions to report, among other information, the amounts billed during the calendar year for qualified tuition and related expenses. Institutions must report separately adjustments made during the calendar year that relate to amounts billed for qualified tuition and related expenses that were reported for a prior calendar year. For purposes of paragraph (b)(3) of this section, an adjustment made to amounts billed means a reduction in charges. Insurers must report the information described in paragraph (b)(4) of this section.

(2) *Information reporting requirements for institutions that elect to report payments received for qualified tuition and related expenses* — (i) *In general.* Except as provided in paragraph (a)(2) of this section, an institution reporting payments received for qualified tuition and related expenses must file an information return with the IRS on Form 1098–T, *Tuition Statement*, with respect to each individual enrolled (as determined in paragraph (d)(1) of this section) for an academic period beginning during the calendar year or during a prior calendar year and for whom a transaction described in paragraph (b)(2)(ii)(C), (E), (F) or (G) of this section is made during the calendar year. An institution may use a substitute Form 1098–T if the substitute form complies with applicable revenue procedures relating to substitute forms (see § 601.601(d)(2) of this chapter).

(ii) *Information included on return.* An institution reporting payments received for qualified tuition and related expenses must include on Form 1098–T —

(A) The name, address, and taxpayer identification number (TIN) (as defined in section 7701(a)(41)) of the institution;

(B) The name, address, and TIN of the individual who is, or has been, enrolled by the institution;

(C) The amount of payments of qualified tuition and related expenses that the institution received from any source with respect to the individual during the calendar year;

(D) An indication by the institution whether any payments received for qualified tuition and related expenses reported for the calendar year relate to an academic period that begins during the first three months of the next calendar year;

(E) The amount of any scholarships or grants for the payment of the individual's costs of attendance that the institution administered and processed during the calendar year;

(F) The amount of any reimbursements or refunds of qualified tuition and related expenses made during the calendar year with respect to the individual that relate to payments of qualified tuition and related expenses that were reported by the institution for a prior calendar year;

(G) The amount of any reductions to the amount of scholarships or grants for the payment of the individual's costs of attendance that were reported by the institution with respect to the individual for a prior calendar year;

(H) A statement or other indication showing whether the individual was enrolled for at least half of the normal full-time work load for the course of study the individual is pursuing for at least one academic period that begins during the calendar year (see section 25A and the regulations thereunder);

(I) A statement or other indication showing whether the individual was enrolled in a program leading to a graduate-level degree, graduate-level certificate, or other recognized graduate-level educational credential; and

(J) Any other information required by Form 1098–T and its instructions.

(iii) *Reportable amount of payments received for qualified tuition and related expenses during calendar year determined.* The amount of payments received for qualified tuition and related expenses with respect to an individual during the calendar year that is reportable on Form 1098–T is determined by netting the amount of payments received (as defined in paragraph (b)(2)(v) of this section) for qualified tuition and related expenses during the calendar year against any reimbursements or refunds (as defined in paragraph (b)(2)(vi) of this section) made during the calendar year that relate to payments received for qualified tuition and related expenses during the same calendar year.

(iv) *Separate reporting of reimbursements or refunds of payments of qualified tuition and related expenses that were reported for a prior calendar year.* An institution must separately report on Form 1098–T any reimbursements or refunds (as defined in paragraph (b)(2)(vi) of this section) made during the current calendar year that relate to payments of qualified tuition and related expenses that were reported by the institution for a prior calendar year. Such reimbursements or refunds shall not be netted against the payments received for qualified tuition and related expenses during the current calendar year.

(v) *Payments received for qualified tuition and related expenses determined.* For purposes of determining the amount of payments received for qualified tuition and related expenses during a calendar year, payments received with respect to an individual during the calendar year from any source (except for any scholarship or grant that, by its terms, must be applied to expenses other than qualified tuition and related expenses, such as room and board) are treated as payments of qualified tuition and related expenses up to the total amount billed by the institution for such expenses. For purposes of this section, a payment includes any positive account balance (such as any reimbursement or refund credited to an individual's account) that an institution applies toward current charges.

(vi) *Reimbursements or refunds of payments for qualified tuition and related expenses determined.* For purposes of determining the amount of reimbursements or refunds made of payments received for

qualified tuition and related expenses, any reimbursement or refund made with respect to an individual during a calendar year (except for any refund of a scholarship or grant that, by its terms, was required to be applied to expenses other than qualified tuition and related expenses, such as room and board) is treated as a reimbursement or refund of payments for qualified tuition and related expenses up to the amount of any reduction in charges for such expenses. For purposes of this section, a reimbursement or refund includes amounts that an institution credits to an individual's account, as well as amounts disbursed to, or on behalf of, the individual.

(vii) *Examples.* The following examples illustrate the rules in this paragraph (b)(2):

Example 1.(i) In early August 2003, University X bills enrolled Student A $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2003 Fall semester. In late August 2003, Student A pays $11,000 to University X. In early September 2003, Student A drops to half-time enrollment for the 2003 Fall semester. In late September 2003, University X credits $5,000 to Student A's account, reflecting a $5,000 reduction in charges for qualified tuition and related expenses. In late September 2003, University X applies the $5,000 positive account balance toward current charges.

(ii) Under paragraph (b)(2)(v) of this section, the $11,000 payment is treated as a payment of qualified tuition and related expenses up to the $10,000 billed for qualified tuition and related expenses. Under paragraph (b)(2)(vi) of this section, the $5,000 credited to the student's account is treated as a reimbursement or refund of payments for qualified tuition and related expenses, because the current year charges for qualified tuition and related expenses were reduced by $5,000. Under paragraph (b)(2)(iii) of this section, University X is required to net the $10,000 payment received for qualified tuition and related expenses during 2003 against the $5,000 reimbursement or refund of payments received for qualified tuition and related expenses during 2003. Therefore, Institution X is required to report $5,000 of payments received for qualified tuition and related expenses during 2003.

Example 2. (i) The facts are the same as in *Example 1*, except that Student A pays the full $16,000 in late August 2003. In late September 2003, University X reduces the tuition charges by $5,000 and issues a $5,000 refund to Student A.

(ii) Under paragraph (b)(2)(v) of this section, the $16,000 payment is treated as a payment of qualified tuition and related expenses up to the $10,000 billed for qualified tuition and related expenses. Under paragraph (b)(2)(vi) of this section, the $5,000 refund is treated as reimbursement or refund of payments for qualified tuition and related expenses, because the current year charges for qualified tuition and related expenses were reduced by $5,000. Under paragraph (b)(2)(iii) of this section, University X is required to net the $10,000 payment received for qualified tuition and related expenses during 2003 against the $5,000 reimbursement or refund of payments received for qualified tuition and related expenses during 2003. Therefore, Institution X is required to report $5,000 of payments received for qualified tuition and related expenses during 2003.

Example 3. (i) The facts are the same as in *Example 1*, except that Student A is enrolled full-time, and, in early September 2003, Student A decides to live at home with her parents. In late September 2003, University X adjusts Student A's account to eliminate room and board charges and issues a $1,000 refund to Student A.

(ii) Under paragraph (b)(2)(v) of this section, the $11,000 payment is treated as a payment of qualified tuition and related expenses up to the $10,000 billed for qualified tuition and related expenses. Under paragraph (b)(2)(vi) of this section, the $1,000 refund is not treated as reimbursement or refund of payments for qualified tuition and related expenses, because there is no reduction in charges for qualified tuition and related expenses. Therefore, under paragraph (b)(2)(iii) of this section, University X is required to report $10,000 of payments received for qualified tuition and related expenses during 2003.

Example 4. (i) In early December 2003, College Y bills enrolled Student B $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2004 Spring semester. In late December 2003, Student B pays $16,000. In mid-January 2004, after the 2004 Spring semester classes begin, Student B drops to half-time enrollment. In mid-January 2004, College Y credits Student B's account with $5,000, reflecting a $5,000 reduction in charges for qualified tuition and related expenses, but does not issue a refund to Student B. In early August 2004, College Y bills Student B $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2004 Fall semester. In early September 2004, College Y applies the $5,000 positive account balance toward Student B's $16,000 bill for the 2004 Fall semester. In late September 2004, Student B pays $6,000 towards the charges.

(ii) In the reporting for calendar year 2003, under paragraph (b)(2)(v) of this section, the $16,000 payment in December 2003 is treated as a payment of qualified tuition and related expenses up to the $10,000 billed for qualified tuition and related expenses. Under paragraph (b)(2)(iii) of this section, College Y is required to report $10,000 of payments received for qualified tuition and related expenses during 2003. In addition, College Y is required to indicate that the payments reported for 2003 relate to an academic period that begins during the first three months of the next calendar year.

(iii) In the reporting for calendar year 2004, under paragraph (b)(2)(vi) of this section, the $5,000 credited to Student B's account is treated as a reimbursement or refund of qualified tuition and related expenses, because the charges for qualified tuition and related expenses were reduced by $5,000. Under paragraph (b)(2)(iv) of this section, the $5,000 reimbursement or refund of qualified tuition and related expenses must be separately reported on Form 1098–T because it relates to payments of qualified tuition and related expenses reported by College Y for 2003. Under paragraph (b)(2)(v) of this section, the $5,000 positive account balance that is applied toward charges for the 2004 Fall semester is treated as a payment. Therefore, College Y received total payments of $11,000 during 2004 (the $5,000 credit plus the $6,000 payment). Under paragraph (b)(2)(v) of this section, the $11,000 of total payments are treated as a payment of qualified tuition and related expenses up to the $10,000 billed for such expenses. Therefore, for 2004, College Y is required to report $10,000 of payments received for qualified tuition and related expenses during 2004 and a $5,000 refund of payments of qualified tuition and related expenses reported for 2003.

(3) *Information reporting requirements for institutions that elect to report amounts billed for qualified tuition and related expenses* — (i) *In general.* Except as provided in paragraph (a)(2) of this section, an institution reporting amounts billed for qualified tuition and related expenses must file an information return on Form 1098–T with respect to each individual enrolled (as determined in paragraph (d)(1) of this section) for an academic period beginning during the calendar year or during a prior calendar year and for whom a transaction described in paragraph (b)(3)(ii)(C), (E), (F) or (G) of this section is made during the calendar year. An institution may use a substitute Form 1098–T if the substitute form complies with applicable revenue procedures relating to substitute forms (see § 601.601(d)(2) of this chapter).

(ii) *Information included on return.* An institution reporting amounts billed for qualified tuition and related expenses must include on Form 1098–T —

(A) The name, address, and taxpayer identification number (TIN) (as defined in section 7701(a)(41)) of the institution;

(B) The name, address, and TIN of the individual who is, or has been, enrolled by the institution;

(C) The amount billed for qualified tuition and related expenses with respect to the individual during the calendar year;

(D) An indication by the institution whether any amounts billed for qualified tuition and related expenses reported for the calendar year relate to an academic period that begins during the first three months of the next calendar year;

(E) The amount of any scholarships or grants for the payment of the individual's costs of attendance that the institution administered and processed during the calendar year;

(F) The amount of any reductions in charges made during the calendar year with respect to the individual that relate to amounts billed for qualified tuition and related expenses that were reported by the institution for a prior calendar year;

(G) The amount of any reductions to the amount of scholarships or grants for the

payment of the individual's costs of attendance that were reported by the institution with respect to the individual for a prior calendar year;

(H) A statement or other indication showing whether the individual was enrolled for at least half of the normal full-time work load for the course of study the individual is pursuing for at least one academic period that begins during the calendar year (see section 25A and the regulations thereunder);

(I) A statement or other indication showing whether the individual was enrolled in a program leading to a graduate-level degree, graduate-level certificate, or other recognized graduate-level educational credential; and

(J) Any other information required by Form 1098–T and its instructions.

(iii) *Reportable amounts billed for qualified tuition and related expenses during calendar year determined.* The amount billed for qualified tuition and related expenses with respect to an individual during the calendar year that is reportable on Form 1098–T is determined by netting the amounts billed for qualified tuition and related expenses during the calendar year against any reductions in charges for qualified tuition and related expenses made during the calendar year that relate to amounts billed for qualified tuition and related expenses during the same calendar year.

(iv) *Separate reporting of reductions made to amounts billed for qualified tuition and related expenses that were reported for a prior calendar year.* An institution must separately report on Form 1098–T any reductions in charges made during the current calendar year that relate to amounts billed for qualified tuition and related expenses that were reported by the institution for a prior calendar year. Such reductions shall not be netted against amounts billed for qualified tuition and related expenses during the current calendar year.

(v) *Examples.* The following examples illustrate the rules in this paragraph (b)(3):

Example 1. (i) In early August 2003, University X bills enrolled Student A $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2003 Fall semester. In late August 2003, Student A pays $11,000 to University X. In early September 2003, Student A drops to half-time enrollment for the 2003 Fall semester. In late September 2003, University X adjusts Student A's account and reduces the charges for qualified tuition and related expenses by $5,000 to reflect half-time enrollment. In late September 2003, University X applies the $5,000 account balance toward current charges.

(ii) Under paragraph (b)(3)(iii) of this section, University X is required to net the $10,000 amount of qualified tuition and related expenses billed during 2003 against the $5,000 reduction in charges for qualified tuition and related expenses during 2003. Therefore, Institution X is required to report $5,000 in amounts billed for qualified tuition and related expenses during 2003.

Example 2. (i) The facts are the same as in *Example 1*, except that, in addition, in early December 2003, College X bills Student A $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2004 Spring semester. In early January 2004, Student A pays $16,000. In mid-January 2004, after the 2004 Spring semester classes begin, Student A drops to half-time enrollment. In mid-January 2004, College X credits $5,000 to Student A's account, reflecting a $5,000 reduction in charges for qualified tuition and related expenses, but does not issue a refund check to Student A. In early August 2004, College X bills Student A $10,000 for qualified tuition and related expenses and $6,000 for room and board for the 2004 Fall semester. In early September 2004, College X applies the $5,000 positive account balance toward Student A's $16,000 bill for the 2004 Fall semester. In late September 2004, Student A pays $6,000 toward the charges.

(ii) In the reporting for calendar year 2003, under paragraph (b)(3)(iii) of this section, College X is required to report $15,000 amounts billed for qualified tuition and related expenses during 2003 ($5,000 for the 2003 Fall semester and $10,000 for the 2004 Spring semester). In addition, College X is required to indicate that some of the amounts billed for qualified tuition and related expenses reported for 2003 relate to an academic period that begins during the first three months of the next calendar year.

(iii) In the reporting for calendar year 2004, under paragraph (b)(3)(iv) of this section, the $5,000 reduction in charges for qualified tuition and related expenses must be separately reported on Form 1098–T because it relates to amounts billed for qualified tuition and related expenses that were reported by College X for 2003. Under paragraph (b)(3)(iii) of this section, College X is required to report $10,000 in amounts billed for qualified tuition and related expenses during 2004.

(4) *Requirements for insurers* — (i) *In general.* Except as otherwise provided in this section, an insurer must file an information return for each individual with respect to whom reimbursements or refunds of qualified tuition and related expenses are made during the calendar year on Form 1098–T. An insurer may use a substitute Form 1098–T if the substitute form complies with applicable revenue procedures relating to substitute forms (see § 601.601(d)(2) of this chapter).

(ii) *Information included on return.* An insurer must include on Form 1098–T —

(A) The name, address, and taxpayer identification number (TIN) (as defined in section 7701(a)(41)) of the insurer;

(B) The name, address, and TIN of the individual with respect to whom reimbursements or refunds of qualified tuition and related expenses were made;

(C) The aggregate amount of reimbursements or refunds of qualified tuition and related expenses that the insurer made with respect to the individual during the calendar year; and

(D) Any other information required by Form 1098–T and its instructions.

(5) *Time and place for filing return* — (i) *In general.* Except as provided in paragraphs (b)(5)(ii) and (iii) of this section, Form 1098–T must be filed on or before February 28 (March 31 if filed electronically) of the year following the calendar year in which payments were received, or amounts were billed, for qualified tuition or related expenses, or reimbursements, refunds, or reductions of such amounts were made. An institution or insurer must file Form 1098–T with the IRS according to the instructions to Form 1098–T.

(ii) *Return for nonresident alien individual.* In general, an institution or insurer is not required to file a return on behalf of a nonresident alien individual. However, if a nonresident alien individual requests an institution or insurer to report, the institution or insurer must file a return described in paragraph (b) of this section with the IRS on or before the date prescribed in paragraph (b)(5)(i) of this section, or on or before the thirtieth day after the request, whichever is later.

(iii) *Extensions of time.* The IRS may grant an institution or insurer an extension of time to file returns required in this section upon a showing of good cause. See General Instructions for Forms 1099 series, 1098 series, 5498 series, and W–2G, *Certain Gambling Winnings*, and applicable revenue procedures for rules relating to extensions of time to file (see § 601.601(d)(2) of this chapter).

(6) *Use of magnetic media.* See section 6011(e) and § 301.6011–2 of this chapter for rules relating to the requirement to file Forms 1098–T on magnetic media.

(c) *Requirement to furnish statement* — (1) *In general.* An institution or insurer must furnish a statement to each individual for whom it is required to file a Form 1098–T. The statement must include —

(i) The information required under paragraph (b) of this section;

(ii) A legend that identifies the statement as important tax information that is being furnished to the IRS;

(iii) Instructions that —

(A) State that the statement reports either total payments received by the institution for qualified tuition and related expenses during the calendar year, or total amounts billed by the institution for qualified tuition and related expenses during the calendar year, or the total reimbursements or refunds made by the insurer;

(B) State that, under section 25A and the regulations thereunder, the taxpayer may claim an education tax credit only with respect to qualified tuition and related expenses actually paid during the calendar year; and that the taxpayer may not be able to claim an education tax credit with respect to the entire amount of payments received, or amounts billed, for qualified tuition and related expenses reported for the calendar year;

(C) State that the amount of any scholarships or grants reported for the calendar year and other similar amounts not reported (because they are not administered and processed by the institution) may reduce the amount of any allowable education tax credit for the taxable year;

(D) State that the amount of any reimbursements or refunds of payments received, or reductions in charges, for qualified tuition and related expenses, or any reductions to the amount of scholarships or grants, reported by the institution with respect to the individual for a prior calendar year may affect the amount of any allowable education tax credit for the prior calendar year (and may result in an increase in tax liability for the year of the refund);

(E) State that the amount of any reimbursements or refunds of qualified tuition and related expenses reported by an insurer may reduce the amount of an allowable education tax credit for a taxable year (and may result in an increase in tax liability for the year of the refund);

(F) State that the taxpayer should refer to relevant IRS forms and publications, and should not refer to the institution or the insurer, for explanations relating to the eligibility requirements for, and calculation of, any allowable education tax credit; and

(G) Include the name, address, and phone number of the information contact of the institution or insurer that filed the Form 1098–T.

(2) *Time and manner for furnishing statement* — (i) *In general.* Except as provided in paragraphs (c)(2)(ii) and (iii) of this section, an institution or insurer must furnish the statement described in paragraph (c)(1) of this section to each individual for whom it is required to file a return, on or before January 31 of the year following the calendar year in which payments were received, or amounts were billed, for qualified tuition and related expenses, or reimbursements, refunds, or reductions of such amounts were made. If mailed, the statement must be sent to the individual's permanent address, or the individual's temporary address if the institution or insurer does not know the individual's permanent address. If furnished electronically, the statement must be furnished in accordance with the applicable regulations.

(ii) *Statement to nonresident alien individual.* If an information return is filed for a nonresident alien individual, the institution or insurer must furnish a statement described in paragraph (c)(1) of this section to the individual in the manner prescribed in paragraph (c)(2)(i) of this section. The statement must be furnished on or before the later of the date prescribed in paragraph (c)(2)(i) of this section or the thirtieth day after the nonresident alien's request to report.

(iii) *Extensions of time.* The IRS may grant an institution or insurer an extension of time to furnish the statements required in this section upon a showing of good cause. See General Instructions for Forms 1099 series, 1098 series, 5498 series, and W–2G, *Certain Gambling Winnings*, and applicable revenue procedures for rules relating to extensions of time to furnish statements (see § 601.601(d)(2) of this chapter).

(3) *Copy of Form 1098–T.* An institution or insurer may satisfy the requirement of this paragraph (c) by furnishing either a copy of Form 1098–T and its instructions or another document that contains all of the information filed with the IRS and the information required by paragraph (c)(1) of this section if the document complies with applicable revenue procedures relating to substitute statements (see § 601.601(d)(2) of this chapter).

(d) *Special rules* — (1) *Enrollment determined.* An institution may determine its enrollment for each academic period under its own rules and policies for determining enrollment or as of any of the following dates —

(i) 30 days after the first day of the academic period;

(ii) A date during the academic period on which enrollment data must be collected for purposes of the Integrated Post Secondary Education Data System administered by the Department of Education; or

(iii) A date during the academic period on which the institution must report enrollment data to the State, the institution's governing body, or some other external governing body.

(2) *Payments of qualified tuition and related expenses received or collected by one or more persons* — (i) *In general.* Except as otherwise provided in paragraph (d)(2)(ii) of this section, if a person collects or receives payments of qualified tuition and related expenses on behalf of another person (*e.g.*, an institution), the person collecting or receiving payments must satisfy the requirements of paragraphs (b) and (c) of this section. In this case, those requirements do not apply to the transfer of the payments to the institution.

(ii) *Exception.* If the person collecting or receiving payments of qualified tuition and related expenses on behalf of another person (*e.g.*, an institution) does not possess the information needed to comply with the requirements of paragraphs (b) and (c) of this section, the other person must satisfy those requirements.

(3) *Governmental units.* An institution or insurer that is a governmental unit, or an agency or instrumentality of a governmental unit, is subject to the requirements of paragraphs (b) and (c) of this section and an appropriately designated officer or employee of the governmental entity must satisfy those requirements.

(e) *Penalty provisions* — (1) *Failure to file correct returns.* The section 6721 penalty may apply to an institution or insurer that fails to file information returns required by section 6050S and this section on or before the required filing date; that fails to include all of the required information on the return; or that includes incorrect in-

formation on the return. See section 6721, and the regulations thereunder, for rules relating to penalties for failure to file correct returns. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(2) *Failure to furnish correct information statements.* The section 6722 penalty may apply to an institution or insurer that fails to furnish statements required by section 6050S and this section on or before the prescribed date; that fails to include all the required information on the statement; or that includes incorrect information on the statement. See section 6722, and the regulations thereunder, for rules relating to penalties for failure to furnish correct statements. See section 6724, and the regulations thereunder, for rules relating to waivers of penalties for certain failures due to reasonable cause.

(3) *Waiver of penalties for failures to include a correct TIN* — (i) *In general.* In the case of a failure to include a correct TIN on Form 1098–T or a related information statement, penalties may be waived if the failure is due to reasonable cause. Reasonable cause may be established if the failure arose from events beyond the institution's or insurer's control, such as a failure of the individual to furnish a correct TIN. However, the institution or insurer must establish that it acted in a responsible manner both before and after the failure.

(ii) *Acting in a responsible manner.* An institution or insurer must request the TIN of each individual for whom it is required to file a return if it does not already have a record of the individual's correct TIN. If the institution or insurer does not have a record of the individual's correct TIN, then it must solicit the TIN in the manner described in paragraph (e)(3)(iii) of this section on or before December 31 of each year during which it receives payments, or bills amounts, for qualified tuition and related expenses or makes reimbursements, refunds, or reductions of such amounts with respect to the individual. If an individual refuses to provide his or her TIN upon request, the institution or insurer must file the return and furnish the statement required by this section without the individual's TIN, but with all other required information. The specific solicitation requirements of paragraph (e)(3)(iii) of this section apply in lieu of the solicitation requirements of § 301.6724–1(e) and (f) of this chapter for the purpose of determining whether an institution or insurer acted in a responsible manner in attempting to obtain a correct TIN. An institution or insurer that complies with the requirements of this paragraph (e)(3) will be considered to have acted in a responsible manner within the meaning of § 301.6724–1(d) of this chapter with respect to any failure to include the correct TIN of an individual on a return or statement required by section 6050S and this section.

(iii) *Manner of soliciting TIN.* An institution or insurer must request the individual's TIN in writing and must clearly notify the individual that the law requires the individual to furnish a TIN so that it may be included on an information return filed by the institution or insurer. A request for a TIN made on Form W–9S, *Request for Student's or Borrower's Taxpayer Identification Number and Certification*, satisfies the requirements of this paragraph (e)(3)(iii). An institution or insurer may establish a system for individuals to submit Forms W–9S electronically as described in applicable forms and instructions. An institution or insurer may also develop a separate form to request the individual's TIN or incorporate the request into other forms customarily used by the institution or insurer, such as admission or enrollment forms or financial aid applications.

(4) *Failure to furnish TIN.* The section 6723 penalty may apply to any individual who is required (but fails) to furnish his or her TIN to an institution or insurer. See section 6723, and the regulations thereunder, for rules relating to the penalty for failure to furnish a TIN.

(f) *Effective date.* The rules in this section apply to information returns required to be filed, and information statements required to be furnished, after December 31, 2003.

PART 301 — PROCEDURE AND ADMINISTRATION

Par. 4. The authority citation for part 301 continues to read in part as follows:

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

Par. 5. Section 301.6011–2 is amended as follows:

1. In paragraph (b)(1), first sentence, add the language "1098–T," immediately after the language "1098–E,".

2. Revising paragraph (g)(3).

The revision reads as follows:

§ 301.6011–2 Required use of magnetic media.

* * * * *

(g) * * *

(3) This section applies to returns on Forms 1098–E, *Student Loan Interest Statement*, and 1098–T, *Tuition Statement*, filed after December 31, 2003.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 6. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 7. In § 602.101, paragraph (b) is amended by adding an entry in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB Control No.
* * * * *	
1.6050S-1	1545-1678
* * * * *	

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

Approved December 12, 2002.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 18, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 19, 2002, 67 F.R. 77678)

Section 6331.—Notice Requirements

26 CFR 301.6331–4: Restrictions on levy while installment agreements are pending or in effect.

T.D. 9027

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Levy Restrictions During Installment Agreements

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations relating to restrictions on levy during the period that an installment agreement is proposed or in effect. The regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998.

EFFECTIVE DATE: These regulations are effective December 18, 2002.

FOR FURTHER INFORMATION CONTACT: Frederick W. Schindler, (202) 622–3620 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations amending the Procedure and Administration Regulations (26 CFR part 301) under section 6331 of the Internal Revenue Code (Code). The regulations reflect the amendment of section 6331 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206 (112 Stat. 685, 764). New section 6331(k) codifies the IRS practice of withholding collection during consideration of a taxpayer's offer to compromise and extends that practice to proposed installment agreements. These regulations deal principally with the effect of subsection 6331(k) when an installment agreement has been proposed and is pending, is in effect, or has been rejected or terminated. On April 17, 2002, a notice of proposed rulemaking (REG–104762–00, 2002–18 I.R.B. 825 [67 FR 18839]) reflecting these changes was published in the **Federal Register.** No written comments on the proposed regulations were received. No public hearing was scheduled or held.

Explanation of Provisions

The regulations provide that, subject to certain exceptions, the IRS may not levy to collect a liability while a taxpayer's proposal to enter into an installment agreement for payment of that liability is pending, for thirty days after rejection of such a proposal, while an installment agreement is in effect, for thirty days after termination of an installment agreement by the IRS, and during a timely filed appeal of a rejection or termination by the IRS. A proposed installment agreement is considered pending when it is accepted for processing by the IRS and remains pending until the IRS accepts or rejects it or the taxpayer withdraws the proposal. The final regulations clarify that the IRS may not accept a proposed installment agreement for processing if jurisdiction over the tax liability at issue has been transferred to the Department of Justice for prosecution or defense. If a proposed installment agreement does not contain sufficient information for the IRS to determine whether the proposal should be accepted, the IRS will request the additional necessary information from the taxpayer and provide a reasonable time period for the taxpayer to respond. The IRS may reject the proposed installment agreement if the requested information is not provided.

Collection by levy is not prohibited if the taxpayer waives the restriction on levy in writing, if the IRS determines that collection of the tax liability is in jeopardy, or if the IRS determines that the proposed installment agreement was submitted solely to delay collection. The exception for proposals submitted solely to delay collection is based on the legislative history accompanying RRA 1998, which explained that Congress did not intend that levy would be prohibited if the IRS determined that an offer to compromise was submitted solely to delay collection. H.R. Conf. Rep. No. 509, 105th Cong., 2d Sess. 288 (1998). Because the legislative history indicates that Congress intended the same restrictions on levy with respect to offers in compromise be applicable to installment agreements, these regulations adopt the same rule with respect to proposed installment agreements.

The regulations provide that the IRS may take actions other than levy to protect the interests of the United States with respect to collection of the liability to which an installment agreement or proposed installment agreement relates. Those actions include, but are not limited to: crediting an overpayment against the liability pursuant to section 6402, filing or refiling notices of Federal tax lien, and taking action to collect from persons liable for the tax but not named in the installment agreement.

The proposed regulations provided that the IRS cannot institute a court proceeding against the taxpayer named in the installment agreement to collect the tax covered by the installment agreement. In the final regulations, this provision has been clarified. It now states that the IRS may not refer a case to the Department of Justice to collect an unpaid tax through a judicial proceeding while levy is prohibited by these regulations. The IRS may, however, authorize the Department of Justice to file a counterclaim in any refund proceeding commenced by a taxpayer, participate in bankruptcy or insolvency cases commenced by or against the taxpayer, or join a taxpayer in any other proceeding in which liability for the tax at issue may be established or disputed. Such proceedings may involve taxes for which more than one person may be jointly and severally liable for the same tax, or may involve persons liable for related liabilities, such as a trust fund recovery penalty under section 6672 or a personal liability for excise tax under section 4103.

While an installment agreement allows the IRS to accept the payment of tax in installments, the agreement does not conclusively establish the taxpayer's liability. A taxpayer therefore is not prohibited from seeking a refund of taxes paid pursuant to an installment agreement. Allowing the IRS

to join the taxpayer in a proceeding where the liability for the tax may be established or disputed will protect the Government from having to litigate the same tax in multiple forums only to face the argument in each separate case (including, potentially, from the taxpayer named in an installment agreement) that the person or persons not party to that suit were solely or principally liable for non-payment of the taxes at issue. The notice of proposed rulemaking stated that if a judgment was obtained against a taxpayer named in an installment agreement, collection would continue to occur pursuant to the terms of the installment agreement. The final regulations clarify that this statement applies only when the Department of Justice refers the case back to the IRS for collection after the judgment is obtained. Section 6331(k) does not limit the collection options of the Department of Justice once a case has been referred to the Department by the IRS.

The regulations provide that the statute of limitations for collection under section 6502 is suspended while a proposed installment agreement is pending, for thirty days after rejection or termination of an installment agreement, and during a timely filed appeal of the rejection or termination decision. The running of the collection statute resumes after an installment agreement takes effect. The statute of limitations for collection shall continue to run if an exception under this section applies and levy is not prohibited with respect to the taxpayer.

These regulations apply to installment agreements proposed or entered into on or after the date final regulations are published in the **Federal Register**. However, the rules set forth in these regulations mirror practices the IRS has been following administratively since the enactment of RRA 1998.

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

Drafting Information

The principal author of these regulations is Frederick W. Schindler, Office of the Associate Chief Counsel (Procedure & Administration), Collection, Bankruptcy & Summonses Division.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR Part 301 is 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. Sections 301.6331–3 and 301.6331–4 are added to read as follows:

§ 301.6331–3 Restrictions on levy while offers to compromise are pending.

Cross-reference. For provisions relating to the making of levies while an offer to compromise is pending, see § 301.7122–1.

§ 301.6331–4 Restrictions on levy while installment agreements are pending or in effect.

(a) *Prohibition on levy*—(1) *In general.* No levy may be made to collect a tax liability that is the subject of an installment agreement during the period that a proposed installment agreement is pending with the Internal Revenue Service (IRS), for 30 days immediately following the rejection of a proposed installment agreement, during the period that an installment agreement is in effect, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, no levy may be made while the rejection or termination is being considered by Appeals. This section will not prohibit levy to collect the liability of any person other than the person or persons named in the installment agreement.

(2) *When a proposed installment agreement becomes pending.* A proposed installment agreement becomes pending when it is accepted for processing. The IRS may not accept a proposed installment agreement for processing following reference of a case involving the liability that is the subject of the proposed installment agreement to the Department of Justice for prosecution or defense. The proposed installment agreement remains pending until the IRS accepts the proposal, the IRS notifies the taxpayer that the proposal has been rejected, or the proposal is withdrawn by the taxpayer. If a proposed installment agreement that has been accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the proposal should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may reject the proposed installment agreement.

(3) *Revised proposals of installment agreements submitted following rejection.* If, following the rejection of a proposed installment agreement, the taxpayer makes a good faith revision of the proposal and submits the revision within 30 days of the date of rejection, the provisions of this section shall apply to that revised proposal.

(4) *Exceptions*. Paragraph (a)(1) of this section shall not prohibit levy if the taxpayer files a written notice with the IRS that waives the restriction on levy imposed by this section, the IRS determines that the proposed installment agreement was submitted solely to delay collection, or the IRS determines that collection of the tax to which the installment agreement or proposed installment agreement relates is in jeopardy.

(b) *Other actions by the IRS while levy is prohibited*—(1) *In general.* The IRS may take actions other than levy to protect the interests of the Government with regard to the liability identified in an installment agreement or proposed installment agreement. Those actions include, for example—

(i) Crediting an overpayment against the liability pursuant to section 6402;

(ii) Filing or refiling notices of Federal tax lien; and

(iii) Taking action to collect from any person who is not named in the installment agreement or proposed installment agreement but who is liable for the tax to which the installment agreement relates.

(2) *Proceedings in court.* Except as otherwise provided in this paragraph (b)(2), the IRS will not refer a case to the Department of Justice for the commencement of a proceeding in court, against a person named in an installment agreement or proposed installment agreement, if levy to collect the liability is prohibited by paragraph (a)(1) of this section. Without regard to whether a person is named in an installment agreement or proposed installment agreement, however, the IRS may authorize the Department of Justice to file a counterclaim or third-party complaint in a refund action or to join that person in any other proceeding in which liability for the tax that is the subject of the installment agreement or proposed installment agreement may be established or disputed, including a suit against the United States under 28 U.S.C. 2410. In addition, the United States may file a claim in any bankruptcy proceeding or insolvency action brought by or against such person. If a person named in an installment agreement is joined in a proceeding, the United States obtains a judgment against that person, and the case is referred back to the IRS for collection, collection will continue to occur pursuant to the terms of the installment agreement.

(c) *Statute of limitations*—(1) *Suspension of the statute of limitations on collection.* The statute of limitations under section 6502 for collection of any liability shall be suspended during the period that a proposed installment agreement relating to that liability is pending with the IRS, for 30 days immediately following the rejection of a proposed installment agreement, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, the statute of limitations for collection shall be suspended while the rejection or termination is being considered by Appeals. The statute of limitations for collection shall continue to run if an exception under paragraph (a)(4) of this section applies and levy is not prohibited with respect to the taxpayer.

(2) *Waivers of the statute of limitations on collection.* The IRS may continue to request, to the extent permissible under section 6502 and § 301.6159–1, that the taxpayer agree to a reasonable extension of the statute of limitations for collection.

(d) *Effective date.* This section is applicable on December 18, 2002.

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

Approved December 11, 2002.

Pamela F. Olson,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on December 17, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 18, 2002, 67 F.R. 77416)

Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Section 7602.—Examination of Books and Witnesses

26 CFR 301.7602–2: Third party contacts.

T.D. 9028

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Third Party Contacts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations providing guidance on third-party contacts made with respect to the determination or collection of tax liabilities. The regulations reflect changes to section 7602 of the Internal Revenue Code made by section 3417 of the Internal Revenue Service Restructuring and Reform Act of 1998. The regulations potentially affect all taxpayers whose Federal tax liabilities are being determined or collected by the IRS.

DATES: *Effective Dates:* These regulations are effective on December 18, 2002.

Applicability Dates: For the date of applicability, see section 301.7602–2(g).

FOR FURTHER INFORMATION CONTACT: Robert A. Miller, 202–622–3630 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 3417 of the IRS Restructuring and Reform Act of 1998 (RRA 1998), Pub. L. No. 105–206 (112 Stat. 685), amended section 7602 by adding section 7602(c). This provision prohibits IRS officers and employees from contacting any person, other than the taxpayer, with respect to the determination or collection of the taxpayer's liability without giving the taxpayer reasonable advance notice that contacts with persons other than the taxpayer may be made.

On January 2, 2001, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG–104906–99, 66 FR 32479) to interpret and implement I.R.C. § 7602(c). Two written comments were received but a public hearing was not held. The proposed regulations, as revised by this Treasury decision, are substantially adopted.

As described more fully in the preamble to the proposed regulations, the final regulations balance a taxpayer's business and reputational interests with third parties' privacy interests and the IRS' responsibility to administer the internal revenue laws effectively. By providing general pre-contact notice followed by post-contact identification, these final regulations enable a taxpayer to come forward with information required by the IRS before third parties are contacted. The taxpayer's business and reputational interests therefore can be addressed without impeding the IRS' ability to make those third-party contacts that are necessary to administer the internal revenue laws.

These final regulations do not finalize the provisions in the proposed regulations regarding periodic reports. Subsequent to the issuance of the proposed regulations, the IRS determined that the issuance of periodic reports may result in harm to third parties and, accordingly, has determined that

periodic reports should not be issued. Taxpayers will continue to receive pre-contact notice and may specifically request from the IRS reports of persons contacted.

Comments on the Proposed Regulations

Section 301.7602–2(e)(3)(ii)—Post Contact Reports

The proposed regulations provided that for contacts with the employees, officers, or fiduciaries of any entity who are acting within the scope of their employment or relationship, it is sufficient to record the entity as the person contacted.

One commentator noted that there may be situations where the name of a specific employee of a business should be recorded and made available to the taxpayer. The commentator suggests adopting a "safe harbor" rule that requires that the name of the party contacted be recorded whenever there is any doubt about how the contact should be recorded. The commentator stated that whenever an employee of a business is contacted due to his or her personal knowledge or business relationship with the taxpayer, the name of the specific employee contacted should be recorded in the contact record rather than (or in addition to) the name of the business entity.

This comment has not been adopted in the final regulations. The final regulations do not prevent IRS employees from providing more than the name of the entity in the record of contact when an employee of a business is contacted. Because the information being sought typically is that of the entity, and not of any specific employee outside of their capacity as an employee, requiring the identification of the specific employees contacted is not required to provide notice to the taxpayer of the contact made and may impede the IRS' ability to obtain information from the entity.

Section 301.7602–2(f)(3)—Reprisal Exception

The proposed regulations provided that a statement by the person contacted that harm may occur is good cause for the IRS to believe that reprisal may occur. Such contacts are not reported by the IRS to the taxpayer.

One commentator asserted that the proposed regulations are inconsistent with the statute's origin and purpose because the proposed regulations (i) subordinate the rights given to taxpayers to the rights of third parties and the IRS; (ii) provide an insufficient threshold for determining whether good cause exists to conclude that reprisal may occur; (iii) permit a third party to express concerns that providing notice to the taxpayer may result in reprisal against another person; (iv) permit the IRS to make a reprisal determination based upon information obtained from any source; and (v) permit the IRS to make a reprisal determination without peer or supervisory review. In brief, the commentator argued that the scope of what would be considered reprisal is too broad and that the determination of when reprisal would be considered to exist is too lenient. The commentator claimed that the adoption of the proposed regulations would render the requirement in section 7602(c) to provide taxpayers with a record of persons contacted a nullity.

The Treasury Department and the IRS do not agree that the proposed regulations are either too broad with respect to what will be considered reprisal or too permissive with respect to the determination of whether the potential for reprisal exists. As a general matter, by including a reprisal exception to the notice requirements of section 7602(c), Congress recognized that the rights of taxpayers to receive notice of third-party contacts must be balanced with the rights of third parties to be free from adverse consequences that may result from the IRS providing such notice. The reprisal exception reflects Congress' determination that a taxpayer's right to know whom the IRS has contacted is outweighed by a third party's right to be free from any reprisal. Moreover, since the statute's effective date, the IRS has been operating under reprisal procedures consistent with the proposed regulations. Based upon the small number of reprisal concerns expressed to date, the Treasury Department and the IRS believe that the final regulations, which make no change to the proposed regulations with respect to this issue, appropriately balance the competing interests reflected in the statute and will not render section 7602(c)(2) a nullity.

More specifically, the Treasury Department and the IRS believe that a third party is in the best position to evaluate its relationship with a taxpayer and the potential for reprisal if a contact with that third party is reported by the IRS to the taxpayer. Requiring the IRS to investigate each claim of potential reprisal, including supervisory review of a reprisal determination, would place a heavy administrative burden on the IRS and, more importantly, would intrude into the third party's affairs and require IRS employees to make judgments that they are not well positioned to make. For these reasons, the final regulations do not adopt the "probable cause" standard suggested by the commentator. In addition, the rights provided to a taxpayer under section 7602(c) (*i.e.*, prior notice that contacts with third parties may be made and a record of persons contacted) cannot be equated with a person's Fourth Amendment right to be free from unreasonable searches and seizures.

In addition, the statute clearly contemplates that the reprisal exception is not limited to concerns of reprisal against the third party contacted. The reprisal exception applies when providing notice to the taxpayer "may involve reprisal against *any person*." I.R.C. § 7602(c)(3)(B) (emphasis added). The statutory exception also does not restrict the source of information that can be used in making a reprisal determination. In certain cases, an IRS employee may be in possession of information that is unknown to the third party contacted but which suggests that reprisal may occur against another person if the contact with the third party is reported to the taxpayer.

Finally, limiting the reprisal exception to physical harm would be inconsistent with the statute and Congress' clear concern that third parties be free from adverse consequences as a result of being contacted by the IRS regarding a taxpayer's liability. Congress did not define or limit the kind of reprisal situations with which it was concerned. Excluding economic, emotional, or other types of harm would significantly diminish the third-party protections provided by the reprisal exception.

Modifications of Proposed Regulations

Section 301.7602–2(c)(1)(i)

The proposed regulations stated that for purposes of section 7602(c), an IRS employee includes, *inter alia*, a person who, through a written agreement with the IRS, is subject to disclosure restrictions consistent with section 6103. The final regulations provide that an IRS employee includes a person described in section 6103(n), an officer or employee of such person, and a person who is subject to disclosure restric-

tions pursuant to a written agreement in connection with the solicitation of an agreement described in section 6103(n) and its implementing regulations. This change was made to provide a legally precise statement of the rule and to clarify that persons who provide tax administration services to the IRS and who enter into nondisclosure agreements with the IRS, as well as prospective bidders who enter into nondisclosure agreements, are treated as IRS employees for purposes of section 7602(c).

Section 301.7602–2(c)(1)(ii) Example 3

The regulations provide that returning unsolicited telephone calls or speaking with persons other than the taxpayer as part of an attempt to speak to the taxpayer are not initiations of third-party contacts. This provision is illustrated by *Example 3*, where a revenue agent trying to contact the taxpayer to discuss the taxpayer's pending examination twice calls the taxpayer's place of business. The first call is answered by a receptionist, and the second call is answered by the office answering machine. The example in the regulations states that in both situations the employee leaves a message "stating only his name, telephone number, that he is with the IRS, and asks that the taxpayer call him." The phrase "that he is with the IRS" has been deleted from the example in the final regulations because there may be situations where it would be inappropriate for an IRS employee to identify his or her employer in a telephone conversation or message that can be seen or heard by persons other than the taxpayer. Section 6304(b)(4).

Section 301.7602–2(c)(3)(ii)

The final regulations add *Examples 6(a)* and *6(b)* to illustrate the application of the third-party contact rules to audits of TEFRA partnerships.

Section 301.7602–2(d)(2)

The regulations provide that the pre-contact notice need not be provided to a taxpayer for third-party contacts when advance notice has otherwise been provided to the taxpayer pursuant to another statute, regulation or administrative procedure. The proposed regulations provide that the Collection Due Process (CDP) notice furnished under section 6330 and its regulations is an example of a situation where the pre-contact notice requirement is fulfilled by another notice. The final regulations modify the proposed regulations to clarify that CDP notices sent to taxpayers pursuant to section 6330 and its regulations constitute reasonable advance notice that contacts with third parties may be made for purposes of effectuating a levy.

Section 301.7602–2(f)(7)

The final regulations add examples to illustrate the application of the nonadministrative contacts exception.

Special Analyses

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

Drafting Information

The principal author of these regulations is Charles B. Christopher of the Office of Associate Chief Counsel, Procedure & Administration (Collection, Bankruptcy & Summonses Division).

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301 — PROCEDURES AND ADMINISTRATION

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

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

Par. 2. Section 301.7602–2 is added to read as follows:

§ 301.7602–2 Third party contacts.

(a) *In general.* Subject to the exceptions in paragraph (f) of this section, no officer or employee of the Internal Revenue Service (IRS) may contact any person other than the taxpayer with respect to the determination or collection of such taxpayer's tax liability without giving the taxpayer reasonable notice in advance that such contacts may be made. A record of persons so contacted must be made and given to the taxpayer upon the taxpayer's request.

(b) *Third-party contact defined.* Contacts subject to section 7602(c) and this regulation shall be called "third-party contacts." A third-party contact is a communication which —

(1) Is initiated by an IRS employee;

(2) Is made to a person other than the taxpayer;

(3) Is made with respect to the determination or collection of the tax liability of such taxpayer;

(4) Discloses the identity of the taxpayer being investigated; and

(5) Discloses the association of the IRS employee with the IRS.

(c) *Elements of third-party contact explained.* (1) *Initiation by an IRS employee* — (i) *Explanation.* (A) *Initiation.* An IRS employee initiates a communication whenever it is the employee who first tries to communicate with a person other than the taxpayer. Returning unsolicited telephone calls or speaking with persons other than the taxpayer as part of an attempt to speak to the taxpayer are not initiations of third-party contacts.

(B) *IRS employee.* For purposes of this section, an IRS employee includes all officers and employees of the IRS, the Chief Counsel of the IRS and the National Taxpayer Advocate, as well as a person described in section 6103(n), an officer or employee of such person, or a person who is subject to disclosure restrictions pursuant to a written agreement in connection with the solicitation of an agreement described in section 6103(n) and its implementing regulations. No inference about the employment or contractual relationship of such other persons with the IRS may be drawn from this regulation for any purpose other than the requirements of section 7602(c).

(ii) *Examples.* The following examples illustrate this paragraph (c)(1):

Example 1. An IRS employee receives a message to return an unsolicited call. The employee returns the call and speaks with a person who reports informa-

tion about a taxpayer who is not meeting his tax responsibilities. Later, the employee makes a second call to the person and asks for more information. The first call is not a contact initiated by an IRS employee. Just because the employee must return the call does not change the fact that it is the other person, and not the employee, who initiated the contact. The second call, however, is initiated by the employee and so meets the first element.

Example 2. An IRS employee wants to hire an appraiser to help determine the value of a taxpayer's oil and gas business. At the initial interview, the appraiser signs an agreement that prohibits him from disclosing return information of the taxpayer except as allowed by the agreement. Once hired, the appraiser initiates a contact by calling an industry expert in Houston and discusses the taxpayer's business. The IRS employee's contact with the appraiser does not meet the first element of a third-party contact because the appraiser is treated, for section 7602(c) purposes only, as an employee of the IRS. For the same reason, however, the appraiser's call to the industry expert does meet the first element of a third-party contact.

Example 3. A revenue agent trying to contact the taxpayer to discuss the taxpayer's pending examination twice calls the taxpayer's place of business. The first call is answered by a receptionist who states that the taxpayer is not available. The IRS employee leaves a message with the receptionist stating only his name and telephone number, and asks that the taxpayer call him. The second call is answered by the office answering machine, on which the IRS employee leaves the same message. Neither of these phone calls meets the first element of a third-party contact because the IRS employee is trying to initiate a communication with the taxpayer and not a person other than the taxpayer. The fact that the IRS employee must either speak with a third party (the receptionist) or leave a message on the answering machine, which may be heard by a third party, does not mean that the employee is initiating a communication with a person other than the taxpayer. Both the receptionist and the answering machine are only intermediaries in the process of reaching the taxpayer.

(2) *Person other than the taxpayer* — (i) *Explanation.* The phrases "person other than the taxpayer" and "third party" are used interchangeably in this section, and do not include —

(A) An officer or employee of the IRS, as defined in paragraph (c)(1)(i)(B) of this section, acting within the scope of his or her employment;

(B) Any computer database or web site regardless of where located and by whom maintained, including databases or web sites maintained on the Internet or in county courthouses, libraries, or any other real or virtual site; or

(C) A current employee, officer, or fiduciary of a taxpayer when acting within the scope of his or her employment or relationship with the taxpayer. Such employee, officer, or fiduciary shall be conclusively presumed to be acting within the scope of his or her employment or relationship during business hours on business premises.

(ii) *Examples:* The following examples illustrate this paragraph (c)(2):

Example 1. A revenue agent examining a taxpayer's return speaks with another revenue agent who has previously examined the same taxpayer about a recurring issue. The revenue agent has not contacted a "person other than the taxpayer" within the meaning of section 7602(c).

Example 2. A revenue agent examining a taxpayer's return speaks with one of the taxpayer's employees on business premises during business hours. The employee is conclusively presumed to be acting within the scope of his employment and is therefore not a "person other than the taxpayer" for section 7602(c) purposes.

Example 3. A revenue agent examining a corporate taxpayer's return uses a commercial online research service to research the corporate structure of the taxpayer. The revenue agent uses an IRS account, logs on with her IRS user name and password, and uses the name of the corporate taxpayer in her search terms. The revenue agent later explores several Internet web sites that may have information relevant to the examination. The searches on the commercial online research service and Internet web sites are not contacts with "persons other than the taxpayer."

(3) *With respect to the determination or collection of the tax liability of such taxpayer* — (i) *Explanation.* (A) *With respect to.* A contact is "with respect to" the determination or collection of the tax liability of such taxpayer when made for the purpose of either determining or collecting a particular tax liability and when directly connected to that purpose. While a contact made for the purpose of determining a particular taxpayer's tax liability may also affect the tax liability of one or more other taxpayers, such contact is not for that reason alone a contact "with respect to" the determination or collection of those other taxpayers' tax liabilities. Contacts to determine the tax status of a pension plan under Chapter 1, Subchapter D (Deferred Compensation) of the Internal Revenue Code, are not "with respect to" the determination of plan participants' tax liabilities. Contacts to determine the tax status of a bond issue under Chapter 1, Subchapter B, Part IV (Tax Exemption Requirements for State and Local Bonds) of the Internal Revenue Code, are not "with respect to" the determination of the bondholders' tax liabilities. Contacts to determine the tax status of an organization under Chapter 1, Subchapter F (Exempt Organizations) of the Internal Revenue Code, are not "with respect to" the determination of the contributors' liabilities, nor are any similar determinations "with respect to" any persons with similar relationships to the taxpayer whose tax liability is being determined or collected.

(B) *Determination or collection.* A contact is with respect to the "determination or collection" of the tax liability of such taxpayer when made during the administrative determination or collection process. For purposes of this paragraph (c) only, the administrative determination or collection process may include any administrative action to ascertain the correctness of a return, make a return when none has been filed, or determine or collect the tax liability of any person as a transferee or fiduciary under Chapter 71 of Title 26.

(C) *Tax liability.* A *tax liability* means the liability for any tax imposed by Title 26 of the United States Code (including any interest, additional amount, addition to the tax, or penalty) and does not include the liability for any tax imposed by any other jurisdiction nor any liability imposed by other Federal statutes.

(D) *Such taxpayer.* A contact is with respect to the determination or collection of the tax liability of "such taxpayer" when made while determining or collecting the tax liability of a particular, identified taxpayer. Contacts made during an investigation of a particular, identified taxpayer are third-party contacts only as to the particular, identified taxpayer under investigation and not as to any other taxpayer whose tax liabilities might be affected by such contacts.

(ii) *Examples.* The following examples illustrate the operation of this paragraph (c)(3):

Example 1. As part of a compliance check on a return preparer, an IRS employee visits the preparer's office and reviews the preparer's client files to ensure that the proper forms and records have been created and maintained. This contact is not a third-party contact "with respect to" the preparer's clients because it is not for the purpose of determining the tax liability of the preparer's clients, even though the agent might discover information that would lead the agent to recommend an examination of one or more of the preparer's clients.

Example 2. A revenue agent is assigned to examine a taxpayer's return, which was prepared by a return preparer. As in all such examinations, the revenue agent asks the taxpayer routine questions about what information the taxpayer gave the preparer and what advice the preparer gave the taxpayer. As a result of the examination, the revenue agent recommends that the preparer be investigated for penalties under section 6694 or 6695. Neither the examination of the taxpayer's return nor the questions asked of the taxpayer are "with respect to" the determination of the pre-

parer's tax liabilities within the meaning of section 7602(c) because the purpose of the contacts was to determine the taxpayer's tax liability, even though the agent discovered information that may result in a later investigation of the preparer.

Example 3. To help identify taxpayers in the florist industry who may not have filed proper returns, an IRS employee contacts a company that supplies equipment to florists and asks for a list of its customers in the past year in order to cross-check the list against filed returns. The employee later contacts the supplier for more information about one particular florist who the employee believes did not file a proper return. The first contact is not a contact with respect to the determination of the tax liability of "such taxpayer" because no particular taxpayer has been identified for investigation at the time the contact is made. The later contact, however, is with respect to the determination of the tax liability of "such taxpayer" because a particular taxpayer has been identified. The later contact is also "with respect to" the determination of that taxpayer's liability because, even though no examination has been opened on the taxpayer, the information sought could lead to an examination.

Example 4. A revenue officer, trying to collect the trust fund portion of unpaid employment taxes of a corporation, begins to investigate the liability of two corporate officers for the section 6672 Trust Fund Recovery Penalty (TFRP). The revenue officer obtains the signature cards for the corporation's bank accounts from the corporation's bank. The contact with the bank to obtain the signature cards is a contact with respect to the determination of the two identified corporate officers' tax liabilities because it is directly connected to the purpose of determining a tax liability of two identified taxpayers. It is not, however, a contact with respect to any other person not already under investigation for TFRP liability, even though the signature cards might identify other potentially liable persons.

Example 5. The IRS is asked to rule on whether a certain pension plan qualifies under section 401 so that contributions to the pension plan are excludable from the employees' incomes under section 402 and are also deductible from the employer's income under section 404. Contacts made with the plan sponsor (and with persons other than the plan sponsor) are not contacts "with respect to" the determination of the tax liabilities of the pension plan participants because the purpose of the contacts is to determine the status of the plan, even though that determination may affect the participants' tax liabilities.

Example 6(a). The IRS audits a TEFRA partnership at the partnership (entity) level pursuant to sections 6221 through 6233. The tax treatment of partnership items is at issue, but the respective tax liabilities of the partners may be affected by the results of the TEFRA partnership audit. With respect to the TEFRA partnership, contacts made with employees of the partnership acting within the scope of their duties or any partner are not section 7602(c) contacts because they are considered the equivalent of contacting the partnership. Contacts relating to the tax treatment of partnership items made with persons other than the employees of the partnership who are acting within the scope of their duties or the partners are section 7602(c) contacts with respect to the TEFRA partnership, and reasonable advance notice should be provided by sending the appropriate Letter 3164 to the partnership's tax matters partner (TMP). Individual partners who are merely affected by the partnership audit but who are not identified as subject to examination with respect to their individual tax liabilities need not be sent Letters 3164.

Example 6(b). In the course of an audit of a TEFRA partnership at the partnership (entity) level, the IRS intends to contact third parties regarding transactions between the TEFRA partnership and specific, identified partners. In addition to the partnership's TMP, the specific, identified partners should also be provided advance notice of any third party contacts relating to such transactions.

(4) *Discloses the identity of the taxpayer being investigated* — (i) *Explanation.* An IRS employee discloses the taxpayer's identity whenever the employee knows or should know that the person being contacted can readily ascertain the taxpayer's identity from the information given by the employee.

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

Example 1. A revenue agent seeking to value the taxpayer's condominium calls a real estate agent and asks for a market analysis of the taxpayer's condominium, giving the unit number of the taxpayer's condominium. The revenue agent has revealed the identity of the taxpayer, regardless of whether the revenue agent discloses the name of the taxpayer, because the real estate agent can readily ascertain the taxpayer's identity from the address given.

Example 2. A revenue officer seeking to value the taxpayer's condominium calls a real estate agent and, without identifying the taxpayer's unit, asks for the sales prices of similar units recently sold and listing prices of similar units currently on the market. The revenue officer has not revealed the identity of the taxpayer because the revenue officer has not given any information from which the real estate agent can readily ascertain the taxpayer's identity.

(5) *Discloses the association of the IRS employee with the IRS.* An IRS employee discloses his association with the IRS whenever the employee knows or should know that the person being contacted can readily ascertain the association from the information given by the employee.

(d) *Pre-contact notice* — (1) *In general.* An officer or employee of the IRS may not make third-party contacts without providing reasonable notice in advance to the taxpayer that contacts may be made. The pre-contact notice may be given either orally or in writing. If written notice is given, it may be given in any manner that the IRS employee responsible for giving the notice reasonably believes will be received by the taxpayer in advance of the third-party contact. Written notice is deemed reasonable if it is —

(i) Mailed to the taxpayer's last known address;

(ii) Given in person;

(iii) Left at the taxpayer's dwelling or usual place of business; or

(iv) Actually received by the taxpayer.

(2) *Pre-contact notice not required.* Pre-contact notice under this section need not be provided to a taxpayer for third-party contacts of which advance notice has otherwise been provided to the taxpayer pursuant to another statute, regulation or administrative procedure. For example, Collection Due Process notices sent to taxpayers pursuant to section 6330 and its regulations constitute reasonable advance notice that contacts with third parties may be made in order to effectuate a levy.

(e) *Post-contact reports* — (1) *Requested reports.* A taxpayer may request a record of persons contacted in any manner that the Commissioner reasonably permits. The Commissioner may set reasonable limits on how frequently taxpayer requests need be honored. The requested report may be mailed either to the taxpayer's last known address or such other address as the taxpayer specifies in the request.

(2) *Contents of record* — (i) *In general.* The record of persons contacted should contain information, if known to the IRS employee making the contact, which reasonably identifies the person contacted. Providing the name of the person contacted fully satisfies the requirements of this section, but this section does not require IRS employees to solicit identifying information from a person solely for the purpose of the post-contact report. The record need not contain any other information, such as the nature of the inquiry or the content of the third party's response. The record need not report multiple contacts made with the same person during a reporting period.

(ii) *Special rule for employees.* For contacts with the employees, officers, or fiduciaries of any entity who are acting within the scope of their employment or relationship, it is sufficient to record the entity as the person contacted. A fiduciary, officer or employee shall be conclusively presumed to be acting within the scope of his employment or relationship during business hours on business premises. For purposes of this paragraph (e)(2)(ii), the term *entity* means any business (whether operated as a sole proprietorship, disregarded entity under § 301.7701–2 of the regulations, or otherwise), trust, estate, partnership, association, company, corporation, or similar organization.

(3) *Post-contact record not required.* A post-contact record under this section need not be made, or provided to a taxpayer, for third-party contacts of which the taxpayer has already been given a similar record pursuant to another statute, regulation, or administrative procedure.

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

Example 1. An IRS employee trying to find a specific taxpayer's assets in order to collect unpaid taxes talks to the owner of a marina. The employee asks whether the taxpayer has a boat at the marina. The owner gives his name as John Doe. The employee may record the contact as being with John Doe and is not required by this regulation to collect or record any other identifying information.

Example 2. An IRS employee trying to find a specific taxpayer and his assets in order to collect unpaid taxes talks to a person at 502 Fernwood. The employee asks whether the taxpayer lives next door at 500 Fernwood, as well as where the taxpayer works, what kind of car the taxpayer drives and whether the camper parked in front of 500 Fernwood belongs to the taxpayer. The person does not disclose his name. The employee may record the contact as being with a person at 502 Fernwood. If the employee then makes the same inquiries of another person on the street in front of 500 Fernwood, and does not learn that person's name, the latter contact may be reported as being with a person on the street in front of 500 Fernwood.

Example 3. An IRS employee examining a return obtains loan documents from a bank where the taxpayer applied for a loan. After reviewing the documents, the employee talks with the loan officer at the bank who handled the application. The employee has contacted only one "person other than the taxpayer." The bank and not the loan officer is the "person other than the taxpayer" for section 7602(c) purposes. The contact with the loan officer is treated as a contact with the bank because the loan officer was an employee of the bank and was acting within the scope of her employment with the bank.

Example 4. An IRS employee issues a summons to a third party with respect to the determination of a taxpayer's liability and properly follows the procedures for such summonses under section 7609, which requires that a copy of the summons be given to the taxpayer. This third-party contact need not be maintained in a record of contacts available to the taxpayer because providing a copy of the third-party summons to the taxpayer pursuant to section 7609 satisfies the post-contact recording and reporting requirement of this section.

Example 5. An IRS employee serves a levy on a third party with respect to the collection of a taxpayer's liability. The employee provides the taxpayer with a copy of the notice of levy form that shows the identity of the third party. This third-party contact need not be maintained in a record of contacts available to the taxpayer because providing a copy of the notice of levy to the taxpayer satisfies the post-contact recording and reporting requirement of this section.

(f) *Exceptions.* (1) *Authorized by taxpayer* — (i) *Explanation.* Section 7602(c) does not apply to contacts authorized by the taxpayer. A contact is "authorized" within the meaning of this section if —

(A) The contact is with the taxpayer's authorized representative, that is, a person who is authorized to speak or act on behalf of the taxpayer, such as a person holding a power of attorney, a corporate officer, a personal representative, an executor or executrix, or an attorney representing the taxpayer; or

(B) The taxpayer or the taxpayer's authorized representative requests or approves the contact.

(ii) *No prevention or delay of contact.* This section does not entitle any person to prevent or delay an IRS employee from contacting any individual or entity.

(2) *Jeopardy* — (i) *Explanation.* Section 7602(c) does not apply when the IRS employee making a contact has good cause to believe that providing the taxpayer with either a general pre-contact notice or a record of the specific person contacted may jeopardize the collection of any tax. For purposes of this section only, good cause includes a reasonable belief that providing the notice or record will lead to —

(A) Attempts by any person to conceal, remove, destroy, or alter records or assets that may be relevant to any tax examination or collection activity;

(B) Attempts by any person to prevent other persons, through intimidation, bribery, or collusion, from communicating any information that may be relevant to any tax examination or collection activity; or

(C) Attempts by any person to flee, or otherwise avoid testifying or producing records that may be relevant to any tax examination or collection activity.

(ii) *Record of contact.* If the circumstances described in this paragraph (f)(2) exist, the IRS employee must still make a record of the person contacted, but the taxpayer need not be provided the record until it is no longer reasonable to believe that providing the record would cause the jeopardy described.

(3) *Reprisal* — (i) *In general.* Section 7602(c) does not apply when the IRS employee making a contact has good cause to believe that providing the taxpayer with either a general pre-contact notice or a specific record of the person being contacted may cause any person to harm any other person in any way, whether the harm is physical, economic, emotional or otherwise. A statement by the person contacted that harm may occur against any person is sufficient to constitute good cause for the IRS employee to believe that reprisal may occur. The IRS employee is not required to further question the contacted person about reprisal or otherwise make further inquiries regarding the statement.

(ii) *Examples.* The following examples illustrate this paragraph (f)(3):

Example 1. An IRS employee seeking to collect unpaid taxes is told by the taxpayer that all the money in his and his brother's joint bank account belongs to the brother. The IRS employee contacts the brother to verify this information. The brother refuses to confirm or deny the taxpayer's statement. He states that he does not believe that reporting the contact to the taxpayer would result in harm to anyone but further states that he does not want his name reported to the taxpayer because it would appear that he gave information. This contact is not excepted from the statute merely because the brother asks that his name be left off the list of contacts.

Example 2. Assume the same facts as in *Example 1*, except that the brother states that he fears harm from the taxpayer should the taxpayer learn of the contact, even though the brother gave no information. This contact is excepted from the statute because the third party has expressed a fear of reprisal. The IRS employee is not required to make further inquiry into the nature of the brothers' relationship or otherwise question the brother's fear of reprisal.

Example 3. An IRS employee is examining a joint return of a husband and wife, who recently divorced. From reading the court divorce file, the IRS employee learns that the divorce was acrimonious and that the ex-husband once violated a restraining order issued to protect the ex-wife. This information provides good cause for the IRS employee to believe that reporting contacts which might disclose the ex-wife's location may cause reprisal against any person. Therefore, when the IRS employee contacts the ex-wife's new employer to verify salary information provided by the ex-wife, the IRS employee has good cause not to report that contact to the ex-husband, regardless of whether the new employer expresses concern about reprisal against it or its employees.

(4) *Pending criminal investigations* — (i) *IRS criminal investigations.* Section 7602(c) does not apply to contacts made during an investigation, or inquiry to determine whether to open an investigation, when the investigation or inquiry is —

(A) Made against a particular, identified taxpayer for the primary purpose of evaluating the potential for criminal prosecution of that taxpayer; and

(B) Made by an IRS employee whose primary duties include either identifying or investigating criminal violations of the law.

(ii) *Other criminal investigations.* Section 7602(c) does not apply to contacts which, if reported to the taxpayer, could interfere with a known pending criminal investigation being conducted by law

enforcement personnel of any local, state, federal, foreign or other governmental entity.

(5) *Governmental entities.* Section 7602(c) does not apply to any contact with any office of any local, state, federal or foreign governmental entity except for contacts concerning the taxpayer's business with the government office contacted, such as the taxpayer's contracts with or employment by the office. The term *office* includes any agent or contractor of the office acting in such capacity.

(6) *Confidential informants.* Section 7602(c) does not apply when the employee making the contact has good cause to believe that providing either the pre-contact notice or the record of the person contacted would identify a confidential informant whose identity would be protected under section 6103(h)(4).

(7) *Nonadministrative contacts* — (i) *Explanation.* Section 7602(c) does not apply to contacts made in the course of a pending court proceeding.

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

Example 1. An attorney for the Office of Chief Counsel needs to contact a potential witness for an upcoming Tax Court proceeding involving the 1997 and 1998 taxable years of the taxpayer. Section 7602(c) does not apply because the contact is being made in the course of a pending court proceeding.

Example 2. While a Tax Court case is pending with respect to a taxpayer's 1997 and 1998 income tax liabilities, a revenue agent is conducting an examination of the taxpayer's excise tax liabilities for the fiscal year ending 1999. Any third-party contacts made by the revenue agent with respect to the excise tax liabilities would be subject to the requirements of section 7602(c) because the Tax Court proceeding does not involve the excise tax liabilities.

Example 3. A taxpayer files a Chapter 7 bankruptcy petition and receives a discharge. A revenue officer contacts a third party in order to determine whether the taxpayer has any exempt assets against which the IRS may take collection action to enforce its federal tax lien. At the time of the contact, the bankruptcy case has not been closed. Although the bankruptcy proceeding remains pending, the purpose of this contact relates to potential collection action by the IRS, a matter not before or related to the bankruptcy court proceeding.

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

David A. Mader,
Assistant Deputy Commissioner of Internal Revenue.

Approved December 12, 2002.

Pamela F. Olson,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 17, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 18, 2002, 67 F.R. 77419)

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of February 2003. See Rev. Rul. 2003–16, page 401.

Part III. Administrative, Procedural, and Miscellaneous

Effective Date of Regulations Under Sections 6011 and 6112

Notice 2003–11

SECTION 1. BACKGROUND

In Treasury Decisions 9017 and 9018, as published in the Federal Register on October 22, 2002 (2002–45 I.R.B. 815 [67 F.R. 64799]; 2002–45 I.R.B. 823 [67 F.R. 64807]) (October 2002 temporary regulations), the Department of the Treasury (Treasury) and the Internal Revenue Service (Service) issued comprehensive amendments to the rules under § 1.6011–4T of the temporary Income Tax Regulations and § 301.6112–1T of the temporary Procedure and Administrative Regulations, and made corresponding amendments to § 301.6111–2T. *See* 2002–45 I.R.B. 815 and 823. These amendments related primarily to the disclosure of reportable transactions under § 6011 of the Internal Revenue Code and the list maintenance requirements for potentially abusive tax shelters under § 6112. Specifically, Treasury and the Service revised and clarified the definition of "reportable transaction" and the definition of "organizer and seller" to ensure that the Service receives the information needed to evaluate certain types of potentially abusive transactions and to improve compliance.

The October 2002 temporary regulations generally are effective for transactions entered into on or after January 1, 2003. Taxpayers are not required to disclose reportable transactions as defined under the October 2002 temporary disclosure regulations until the time they file their tax return reporting those transactions. However, under the October 2002 temporary list maintenance regulations, material advisors have an immediate obligation to maintain lists with respect to reportable transactions.

Treasury and the Service have received numerous comments relating to the October 2002 temporary disclosure regulations and the October 2002 temporary list maintenance regulations. Treasury and the Service are currently reviewing these comments. In particular, Treasury and the Service are reviewing the comments that provide suggested clarifications to the rules pertaining to who must disclose transactions. In addition, Treasury and the Service are considering clarifications as to the persons required to maintain lists and the persons who must be included on lists.

Treasury and the Service also are reviewing the comments relating to the reportable transaction categories of loss transactions and transactions with a significant book-tax difference. More generally, Treasury and the Service are considering how the rules in the October 2002 temporary regulations can be revised to exclude transactions for which disclosure and maintenance of information under §§ 6011 and 6112 may be unnecessary, while preserving the ability of Treasury and the Service to obtain information about potentially abusive transactions. Treasury and the Service intend to publish final regulations in February 2003.

SECTION 2. EFFECTIVE DATE FOR THE DISCLOSURE REGULATIONS UNDER § 6011

Treasury and the Service intend to revise the disclosure regulations under § 6011 to reflect the consideration of the comments received. Although the October 2002 temporary disclosure regulations under § 6011 will continue to apply to transactions entered into on or after January 1, 2003, the revised regulations under § 6011 will permit taxpayers who entered into transactions on or after January 1, 2003, and before the filing date of the revised regulations, to elect to apply the revised regulations instead of the October 2002 temporary disclosure regulations.

SECTION 3. EFFECTIVE DATE FOR THE LIST MAINTENANCE REGULATIONS UNDER § 6112

In order to provide necessary clarification to the October 2002 temporary list maintenance regulations, Treasury and the Service will change the effective date of the October 2002 temporary list maintenance regulations under § 6112 to the date the revised regulations under § 6112 are filed. Except as provided below, the list maintenance requirements under § 6112 will not apply to transactions entered into on or after January 1, 2003, and before the filing date of the revised regulations under § 6112. The delayed effective date, however, will not apply to listed transactions or transactions that are § 6111 shelters as defined in § 301.6112–1T(b)(1) of the October 2002 temporary regulations.

SECTION 4. CONTACT INFORMATION

The principal author of this notice is Tara P. Volungis of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this notice, contact Ms. Volungis at (202) 622–3080 (not a toll-free call).

Nonaccrual Experience Method of Accounting

Notice 2003–12

SECTION 1. PURPOSE

The Internal Revenue Service is currently working on regulations under § 448(d)(5) of the Internal Revenue Code as amended by § 403 of the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107–147, § 403, 116 Stat. 21 (the Act), regarding the nonaccrual experience ("NAE") method. Until such regulations are issued in final form, this notice provides interim guidance on which taxpayers may rely. The Service expects that the final regulations will incorporate the rules set forth in this notice and will be effective for taxable years ending after March 9, 2002. This interim guidance includes: (1) for taxpayers who no longer qualify to use a NAE method, procedures to change their method of accounting; (2) for taxpayers who qualify to use a NAE method, two safe harbor NAE methods that will be presumed to clearly reflect the taxpayer's NAE; (3) for taxpayers who qualify to use a NAE method but wish to compute their NAE using a formula other than the two safe harbors provided, the requirements that must be met in order to use an alternative formula to compute their NAE; and (4) for taxpayers who wish to change to a different NAE method, the procedures necessary to obtain automatic consent of the Commissioner to change to one of the safe harbor

NAE methods or to an alternative NAE method that clearly reflects their experience.

SECTION 2. BACKGROUND

.01 Under § 448(d)(5), prior to its amendment by the Act, taxpayers using an accrual method of accounting and performing services were not required to accrue any portion of their service-related income that, on the basis of their experience, would not be collected. The Act modifies § 448(d)(5) to provide that a NAE method is now available only for taxpayers using an accrual method who either provide services in fields described in § 448(d)(2)(A) (*i.e.*, health, law, engineering, architecture, accounting, actuarial science, performing arts, or consulting), or who meet the $5 million annual gross receipts test of § 448(c). As under prior law, a NAE method is available only to taxpayers not charging interest or penalties for failure to timely pay the amount charged.

.02 The Act also provides that the Service and the Treasury Department will issue regulations to permit taxpayers to determine the uncollectible amounts using alternative computations or formulas, including safe harbors, that, based on experience, accurately reflect the amount of income that the taxpayers will not collect. The amendments by the Act are effective for taxable years ending after March 9, 2002.

SECTION 3. NONACCRUAL EXPERIENCE METHODS

.01 *In General.* Pending the issuance of final regulations under § 448(d)(5), as amended, a taxpayer eligible to use a NAE method under § 448(d)(5), as amended, may use one of two safe harbor NAE methods of accounting provided in section 3.02 of this notice. Alternatively, a taxpayer eligible to use a NAE method under § 448(d)(5), as amended, may use any other NAE method (an "alternative NAE method") that clearly reflects the taxpayer's NAE, subject to the requirements of section 3.03 of this notice. See section 5 of this notice for procedures to obtain automatic consent to change to one of the safe harbor NAE methods or to an alternative NAE method.

.02 *Safe Harbor Methods.* The safe harbor NAE methods provided in this section 3.02 will be presumed to clearly reflect a taxpayer's NAE.

(1) *Section 1.448–2T(e)(2) method.* A taxpayer may use the NAE method provided in § 1.448–2T(e)(2) of the temporary income tax regulations.

(2) *Actual experience method.* (i) *Option A: Three-year moving average.* A taxpayer may use a NAE method under which the taxpayer determines the uncollectible amount ("actual NAE amount") by multiplying its year-end accounts receivable balance by a percentage ("three-year moving average NAE percentage") reflecting its actual NAE with respect to its accounts receivable balance at the beginning of the current taxable year and the two immediately preceding taxable years. Under the actual experience method, a taxpayer is allowed to increase its actual NAE amount by 5% ("adjusted NAE amount"). The taxpayer's three-year moving average NAE percentage, actual NAE amount, and adjusted NAE amount are determined according to the following steps:

STEP 1. Track the receivables in the taxpayer's accounts receivable balance at the beginning of the current year to determine the dollar amount of the accounts receivable actually determined to be uncollectible and charged off and not recovered or determined to be collectible by the date selected by the taxpayer (the "determination date") for the year. The determination date may not be later than the earlier of the due date (including extensions) for filing the taxpayer's federal income tax return for that year or the date on which the taxpayer files such return for that year.

STEP 2. Repeat STEP 1 for the taxpayer's accounts receivable balance at the beginning of each of the two immediately preceding taxable years.

STEP 3. To determine the taxpayer's three-year moving average NAE percentage, (i) divide the sum of the net uncollectible amounts from STEP 1 and 2, by (ii) the sum of the accounts receivable balance at the beginning of the current taxable year and the accounts receivable balance at the beginning of each of the two preceding taxable years.

STEP 4. Multiply the percentage computed in STEP 3 by the taxpayer's accounts receivable balance at the end of the current taxable year. The product is the taxpayer's actual NAE amount for the current taxable year.

STEP 5. To determine the taxpayer's adjusted NAE amount, multiply the actual NAE amount from STEP 4 by 1.05. *See Example 1* in section 3.04 of this notice.

(ii) *Option B: Up to three-year moving average.* Alternatively, in computing its adjusted NAE amount, a taxpayer may use: its current year NAE percentage for the first year this method is used; a two-year moving average NAE percentage for the second year this method is used; and a three-year moving average NAE percentage for the third, and each succeeding, taxable year this method is used. *See Examples 2, 3* and *4* in section 3.04 of this notice.

(iii) A taxpayer that excludes an amount from income during a taxable year as a result of the taxpayer's use of the actual experience method cannot deduct in any subsequent taxable year the amount excluded from income. Thus, the taxpayer cannot deduct the excluded amount in the next taxable year, which is the taxable year in which the taxpayer actually determines that the amount is uncollectible and charges the amount off. If a taxpayer recovers an amount excluded from income, the taxpayer must include the recovered amount in income. If a calendar year taxpayer using the actual experience method determines that an amount that was not excluded from income is uncollectible and should be charged off (*e.g.*, the taxpayer determines on November 1, 2002, that an account receivable that was originated on May 1, 2002, is uncollectible and should be charged off) the taxpayer may deduct the amount charged off when it is charged off, but must include any subsequent recoveries in income. The reasonableness of a taxpayer's determinations that amounts are uncollectible and should be charged off may be considered on examination. *See* §§ 1.448–2T(e)(3) and (e)(4) regarding the mechanics of the NAE method and related examples.

.03 *Alternative NAE Methods.* A taxpayer may use any alternative NAE method that clearly reflects the taxpayer's actual NAE, provided the taxpayer's alternative NAE method meets the self-test requirements as described in this section 3.03.

(1) *Self-testing.* A taxpayer using (or desiring to use) an alternative NAE method must "self-test" its alternative NAE method for its first taxable year ending after March 9, 2002, and every third taxable year thereafter by comparing the NAE amount under the taxpayer's alternative NAE method

("alternative NAE amount") with the adjusted NAE amount that would have resulted from use of the actual experience method, as described in section 3.02(2) of this notice, for the test period. In no event will the test period include taxable years ending on or before March 9, 2002, or prior to the first year in which the taxpayer used its alternative NAE method.

(2) *Treated as clearly reflecting NAE.* If the total of the alternative NAE amounts for each year of the test period ("cumulative alternative NAE amount") is less than or equal to the total of the adjusted NAE amount computed under STEP 5 of section 3.02(2)(i) of this revenue procedure for each year of the test period ("cumulative adjusted NAE amount"), then: (i) the taxpayer's alternative NAE method will be treated as clearly reflecting its NAE for the test period; and (ii) the taxpayer may continue to use that alternative NAE method, subject to a requirement to self-test again in three taxable years. *See Example* 6 in section 3.04 of this notice.

(3) *Treated as not clearly reflecting NAE.* If the cumulative alternative NAE amount is more than the cumulative adjusted NAE amount for the test period, then: (i) the taxpayer's alternative NAE method will be treated as not clearly reflecting its NAE for the test period; and (ii) the taxpayer must change its NAE method of accounting to a method that will clearly reflect its NAE. *See Examples 7* and *8* in section 3.04 of this notice.

(4) *Changes to or from alternative NAE methods.* A taxpayer that voluntarily changes its NAE method of accounting as a result of section 3.03(3) of this notice should follow the automatic change in method of accounting procedures described in section 5.02 of this notice. A taxpayer that must change its NAE method of accounting as a result of section 3.03(3) of this notice, but does not change, will be subject to being changed by the Service on examination to the actual experience method. A taxpayer that does not maintain records of the data necessary to determine its actual NAE (in accordance with section 3.02(2) of this notice) will be subject to being changed by the Service on examination to the specific charge-off method. A taxpayer described in this section that is required by the Service to change its NAE method of accounting on examination will be subject to such change in the earliest open taxable year under examination, and will be required to take into account any resulting § 481(a) adjustment entirely in the year of change, and may be subject to penalties. *See* § 446(f).

.04 *Examples.* In each example, the taxpayer: (1) uses a calendar year for federal income tax purposes and an accrual method of accounting; (2) is eligible to use a NAE method under § 448(d)(5), as amended by the Act; and (3) selects an appropriate determination date for each taxable year. In each of *Examples 1–5*, the taxpayer wants to use the actual experience method beginning in 2002.

Example 1. Taxpayer *A* has the data necessary to track the uncollectible amounts in its beginning-of-year accounts receivable for the current taxable year and the two immediately preceding taxable years. *A* determines that its actual accounts receivable collection experience is as follows:

Year	*Total A/R Balance At Beginning of Year*	*Beginning A/R Amount Charged Off by Determination Date (adjusted for recoveries)*
2000	$1,000,000	$35,000
2001	760,000	75,000
2002	1,975,000	65,000
Total	$3,735,000	$175,000

A's ending A/R Balance on 12/31/2002, is $880,000.

In 2002, *A* chooses to compute its NAE amount by using the three-year moving average under Option A in section 3.02(2)(i) of this notice. Thus, *A's* three-year moving average NAE percentage is 4.7%, determined by dividing the sum of the amount of *A's* receivables in its account on January 1st of 2000, 2001, and 2002, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding determination dates, by the sum of the balances of *A's* accounts receivable account on January 1st of 2000, 2001, and 2002 (*i.e.*, $175,000/$3,735,000 or 4.7%). Thus, *A's* actual NAE amount for 2002 is determined by multiplying this percentage by the balance of *A's* accounts receivable account on December 31, 2002 (*i.e.*, $880,000 x 4.7% = $41,360). *A* is permitted to exclude from gross income in 2002 an amount equal to 105% of *A's* actual NAE amount ($41,360 x 105% = $43,428). This is *A's* adjusted NAE amount for 2002.

Example 2. The facts are the same as *Example 1*, except *A* has not maintained the data necessary to use Option A in section 3.02(2)(i) of this notice. *A* determines that, of its 2002 beginning-of-year receivables of $1,975,000, $65,000 were determined to be uncollectible and charged off (adjusted for recoveries) on or before September 15, 2003, the date *A* timely files its federal income tax return for 2002 (the determination date). *A* chooses to use Option B in section 3.02(2)(ii) of this notice to compute its adjusted NAE amount for 2002. *A*'s current year NAE percentage is 3.3%, determined by dividing the amount of *A*'s receivables in its account on January 1, 2002, that were charged off as uncollectible (adjusted for recoveries) on or before the determination date, by the balance of *A*'s accounts receivable account on January 1, 2002 (*i.e.*, $65,000/$1,975,000 or 3.3%). Thus, *A*'s actual NAE amount for 2002 is determined by multiplying this percentage by the balance of *A*'s accounts receivable account on December 31, 2002 (*i.e.*, $880,000 x 3.3% = $29,040). *A* is permitted to exclude from gross income in 2002 an amount equal to 105% of *A*'s actual NAE amount ($29,040 x 105% = $30,492). This is *A*'s adjusted NAE amount for 2002.

Example 3. The facts are the same as *Example 2*. *A* determines that its accounts receivable collection experience for 2003 is as follows:

Year	Total A/R Balance At Beginning of Year	Beginning A/R Amount Charged Off by Determination Date (adjusted for recoveries)
2002	$1,975,000	$65,000
2003	880,000	95,000
Total	$2,855,000	$160,000

A's ending A/R Balance on 12/31/2003, is $ 2,115,000.

In 2003, *A* must compute its NAE amount using an average of its actual NAE for 2002 and 2003 (in accordance with Option B in section 3.02(2)(ii) of this notice). Thus, *A*'s two-year moving average NAE percentage is 5.6%, determined by dividing the sum of the amount of *A*'s receivables in its accounts on January 1st of 2002 and 2003, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding determination dates, by the sum of the balances of *A*'s accounts receivable account on January 1st of 2002 and 2003 (*i.e.*, $160,000/$2,855,000 or 5.6%). Thus, *A*'s actual NAE amount for 2003 is determined by multiplying this percentage by the balance of *A*'s accounts receivable account on December 31, 2003 (*i.e.*, $2,115,000 x 5.6% = $118,440). *A* is permitted to exclude from gross income in 2003 an amount equal to 105% of *A*'s actual NAE amount ($118,440 x 105% = $124,362). This is *A*'s adjusted NAE amount for 2003.

Example 4. The facts are the same as *Example 3*. *A* determines that its accounts receivable collection experience for 2004 is as follows:

Year	Total A/R Balance At Beginning of Year	Beginning A/R Amount Charged Off by Determination Date (adjusted for recoveries)
2002	$1,975,000	$65,000
2003	880,000	95,000
2004	2,115,000	105,000
Total	$4,970,000	$265,000

A's ending A/R Balance on 12/31/2004, is $1,600,000.

In 2004, *A* must compute its NAE amount using an average of its actual NAE for 2002, 2003, and 2004 (in accordance with Option B in section 3.02(2)(ii) of this notice). Thus, *A*'s actual three-year moving average NAE percentage is 5.3%, determined by dividing the sum of the amount of *A*'s receivables in its account on January 1st of 2002, 2003, and 2004, that were determined to be uncollectible and charged off (adjusted for recoveries) on or before the corresponding determination dates, by the sum of the balances of *A*'s accounts receivable account on January 1st of 2002, 2003, and 2004 (*i.e.*, $265,000/$4,970,000 or 5.3%). Thus, *A*'s actual NAE amount for 2004 is determined by multiplying this percentage by the balance of *A*'s accounts receivable account on December 31, 2004 (*i.e.*, $1,600,000 x 5.3% = $84,800). *A* is permitted to exclude from gross income in 2004 an amount equal to 105% of *A*'s actual NAE amount ($84,800 x 105% = $89,040). This is *A*'s adjusted NAE amount for 2004. Thereafter, *A* must continue to use a 3-year moving average to compute its actual NAE, or obtain approval of the Commissioner to change its method of accounting.

Example 5. Taxpayer *B* has not tracked its 2002 beginning-of-year accounts receivable. Therefore, *B* may not use the actual experience method for 2002. *B* may use this method for 2003 if *B* tracks its 2003 beginning-of-year receivables.

Example 6. Beginning in 2002, taxpayer *C* uses an alternative NAE method similar to the method described in *Black Motor Co. v. Comm'r*, 41 B.T.A. 300 (1940), *aff'd*, 125 F.2d 977 (6th Cir. 1942). *C* must self-test its alternative NAE method for the first year it is used (2002), and then every three taxable years after 2002 for which *C* uses its alternative NAE method. Thus, beginning in 2002, *C* must begin tracking its beginning-of-year accounts receivable and computing its actual NAE as provided in section 3.02(2) of this notice. *C*'s actual NAE amount and alternative NAE amount for 2002 are set forth below:

Year	Total A/R Balance At Beginning of Year	Beginning A/R Amount Charged Off by Determination Date (adjusted for recoveries)	Alternative NAE Amount
2002	$350,000	$14,000	$20,700

C's ending A/R Balance on 12/31/2002, is $500,000.

C's actual NAE percentage is 4%, determined by dividing the amount of *C*'s receivables in its account on January 1, 2002, that were charged off as uncollectible (adjusted for recoveries) on or before the determination date, by the balance of *C*'s accounts receivable account on January 1, 2002 (*i.e.*, $14,000/$350,000 or 4%). Thus, *C*'s actual NAE amount for 2002 is determined by multiplying this percentage by the balance of *C*'s accounts receivable account on December 31, 2002 (*i.e.*, $500,000 x 4% = $20,000). Because *C*'s alternative NAE amount for 2002 ($20,700) is not greater than 105% of its actual NAE amount for 2002 (*i.e.*, $20,000 x 1.05 = $21,000), *C*'s alternative NAE method will be treated as clearly reflecting its actual NAE for the test period 2002. *C*'s next test period would be taxable years 2003 through 2005. *C*'s actual NAE amounts (computed under Option B of section 3.02(2) of this revenue procedure, because *C* lacked the data to use Option A) and alternative NAE amounts for those years are set forth below:

Year	Total A/R Balance At Beginning of Year	Beginning A/R Amount Charged Off by Determination Date (adjusted for recoveries)	Actual NAE Amount	Alternative NAE Amount
2003	$440,000	$30,000	$42,329	$43,050
2004	760,000	65,000	138,183	140,200
2005	1,965,000	65,000	101,106	110,550
Total	$3,165,000	$160,000	$281,618	$293,800

Assume that *C*'s ending A/R balance on 12/31/05, is $2,000,000.

Because *C*'s cumulative alternative NAE amount for this period ($293,800) is not greater than 105% of its cumulative actual NAE amount for the same period (*i.e.*, $281,618 x 1.05 = $295,699), *C*'s alternative NAE method will be treated as clearly reflecting its actual NAE for the test period. Accordingly, *C* may continue to use its alternative NAE method, subject to the requirement that *C* self-test again after the next three taxable years.

Example 7. The facts are the same as *Example 6*, except that *C*'s alternative NAE amount for 2002 is $21,700. Because *C*'s alternative NAE amount for 2002 is more than 105% of its actual NAE amount for 2002 (*i.e.*, $20,000 x 1.05 = $21,000), *C*'s alternative NAE method will be treated as not clearly reflecting its NAE for the test period. As a result, *C* cannot use its alternative NAE method of accounting, but must use a method that will clearly reflect its NAE for 2002.

Example 8. The facts are the same as *Example 7*, except that C used its alternative NAE method in taxable years prior to 2002. Because *C*'s alternative NAE method will be treated as not clearly reflecting its NAE for the test period, *C* will be required to change its NAE method of accounting to a method that will clearly reflect its NAE for 2002.

SECTION 4. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE ACTUAL EXPERIENCE METHOD

If a taxpayer uses the actual experience method described in section 3.02(2) of this notice to determine its NAE amount, the taxpayer's use of that method will not be raised as an issue by the Service in a taxable year that ends before January 22, 2003. If the taxpayer uses the actual experience method described in section 3.02(2) of this notice, and its use of that method is an issue under consideration (within the meaning of section 3.09 of Rev. Proc. 2002–9) in examination, in appeals, or before the U.S. Tax Court in a taxable year that ends before January 22, 2003, that issue will not be further pursued by the Service.

SECTION 5. APPLICATION

.01 *Taxpayers No Longer Qualified Under § 448 to Use a NAE Method.* In the case of a taxpayer that is no longer qualified under § 448(d)(5), as amended by the Act, to use a NAE method for its first taxable year ending after March 9, 2002, the change from the taxpayer's NAE method is treated as initiated by the taxpayer, made with the consent of the Commissioner, and the net amount of the required § 481(a) adjustment is to be taken into account over a period of 4 taxable years (or, if less, the number of taxable years that the taxpayer has used the NAE method). Such a taxpayer is not required to file Form 3115, *Application for Change in Accounting Method*, with the national office, or pay any associated user fee. However, to assist the Service in processing the taxpayer's change in method of accounting, the taxpayer should attach Form 3115 to its income tax return for the year of change, and write "Change off of the nonaccrual experience method under Notice 2003–12" at the top of the form.

.02 *Taxpayers Permitted to Use a NAE Method.* A change to a NAE method, or a change from one NAE method to another NAE method, is a change in method of accounting to which the provisions of §§ 446 and 481, and the regulations thereunder, apply. Therefore, a taxpayer that wants to use one of the NAE methods provided in this notice, and that does not currently use that method, must follow the automatic change in method of accounting procedures in Rev. Proc. 2002–9, 2002–3 I.R.B. 327 (as modified and amplified by Rev. Proc. 2002–19, 2002–13 I.R.B. 696, modified and clarified by Announcement 2002–17, 2002–8 I.R.B. 561, and amplified, clarified, and modified by Rev. Proc. 2002–54, 2002–35 I.R.B. 432) (or successors), with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to change to a NAE method provided in this notice for either its first or second taxable year ending after March 9, 2002, provided the taxpayer's NAE method is not an issue under consideration for taxable years under examination, within the meaning of section 3.09 of Rev. Proc. 2002–9, at the time the Form 3115 is filed with the national office (subject to the exception in Section 4 of this notice);

(2) A taxpayer that wants to change to a NAE method provided in this notice for its first taxable year ending after March 9, 2002, that on or before March 12, 2003, files its original federal income tax return for that year is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002–9, provided the taxpayer complies with the following filing requirements. The taxpayer must complete and file the Form 3115 in duplicate. The original Form 3115 must be attached to an amended federal income tax return for the taxpayer's first taxable year ending after March 9, 2002. This amended return must be filed no later than August 11, 2003. The copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002–9 for the address) no later than when the taxpayer's amended return is filed; and

(3) When filing the Form 3115, the taxpayer must complete all applicable parts of the form and, in lieu of the label required by section 6.02(4) of Rev. Proc. 2002–9, are instructed to write "Change to [identify the requested NAE method] under Notice 2003–12" at the top of the form.

.03 *Taxpayers That Must Change After Self-Testing.* If a taxpayer required to change its method of accounting as a result of section 3.03 of this notice properly applied its alternative NAE method during the test period and the taxpayer makes the change for its first taxable year following the last taxable year of the test period, the taxpayer must follow the automatic change in method

of accounting procedures in Rev. Proc. 2002–9 (or successors) and the scope limitations of section 4.02 of Rev. Proc. 2002–9 will not apply.

SECTION 6. EFFECTIVE DATE AND TRANSITION RULE

.01 *In General.* This notice is effective for taxable years ending after March 9, 2002.

.02 *Transition Rule.* If a taxpayer filed an application or ruling request under the procedures prescribed in Rev. Proc. 97–27, 1997–1 C.B. 680, with the national office to make a change in its method of accounting under § 448(d)(5), as amended, for a year of change for which this notice is effective and the application or ruling request is pending with the national office on January 22, 2003, the taxpayer must notify the national office in writing (see section 8.06 of Rev. Proc. 97–27 for the address) prior to March 24, 2003, if the taxpayer wants the national office to continue processing its application or ruling request under the procedures prescribed in Rev. Proc. 97–27. If the taxpayer does not notify the national office within the time provided in this section, the taxpayer's Form 3115, and any user fee that was submitted with the Form 3115, will be returned to the taxpayer. A taxpayer whose Form 3115 is returned under this section may file a new Form 3115 under the procedures prescribed in section 5.02 of this notice.

SECTION 7. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified to include the changes in method of accounting provided in this notice in section 5.06 of the Appendix.

REQUEST FOR COMMENTS

The Service and the Treasury Department invite comments on the safe harbor NAE methods described in this notice, suggestions for additional safe harbor NAE methods, the use of a "self-test" for alternative NAE methods, as well as any other issues that should be addressed in the forthcoming regulations. Written comments may be submitted on or before April 23, 2003, to:

Internal Revenue Service
P.O. Box 7604
Benjamin Franklin Station
Washington, DC 20224
Attn: CC:ITA:RU (Notice 2002–12), Room 5226

Submissions also may be sent electronically via the Internet to the following e-mail address: *notice.comments@m1.irscounsel.treas.gov.* Comments will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this notice is Terrance McWhorter of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. McWhorter at 202–622–4970 (not a toll-free call).

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26 CFR 601.201: Rulings and determination letters.
(Also Part 1, section 846; 1.846–1.)

Rev. Proc. 2003–17

SECTION 1. PURPOSE

This revenue procedure prescribes the loss payment patterns and discount factors for the 2002 determination year. These factors will be used to compute discounted unpaid losses under § 846 of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Section 846 provides that discounted unpaid losses must be separately determined for each accident year of each line of business by applying an interest rate determined under § 846(c) and the appropriate loss payment pattern to the amount of unpaid losses as measured at the end of the tax year.

Section 846(d) directs the Secretary to use the most recent aggregate loss payment data of property and casualty insurance companies to determine and publish a loss payment pattern for each line of business every five years. This payment pattern is used to discount unpaid losses for the accident year ending with a determination year and for each of the four succeeding accident years.

Section 846(e) allows a taxpayer to make an election in each determination year to use its own historical payment pattern instead of the Secretary's tables. This election does not apply to any international insurance or reinsurance line of business.

Section 846(f)(4) defines the term "line of business" as a category for the reporting of loss payment patterns on the annual statement for fire and casualty companies approved by the National Association of Insurance Commissioners (NAIC), except that the multiple peril lines shall be treated as a single line of business. Section 846(f)(5) states that the term "multiple peril lines" means the lines of business relating to farmowners multiple peril, homeowners multiple peril, commercial multiple peril, ocean marine, aircraft (all perils) and boiler and machinery.

.02 Pursuant to § 846(d), the Secretary has determined a loss payment pattern for each property and casualty line of business for the 2002 determination year that, pursuant to § 846(d)(1), must be applied through the 2006 accident year.

.03 The loss payment patterns for the 2002 determination year are based on the aggregate loss payment information reported on the 2000 annual statements of property and casualty insurance companies and compiled by A.M. Best and Co. The tables are arranged in alphabetical order. Following is an additional explanation of some of the tables and changes to the tables.

(1) *Lines of Business.* The lines of business for the 2002 determination year are the same as the lines of business for the 1997 determination year. *See* Rev. Proc. 98–11, section 2.03, 1998–1 C.B. 358.

(2) *Format of the Tables.* To simplify the tables, the columns entitled Tax Year provide the actual tax years, rather than AY+0, AY+1, and so on.

(3) *Accident Years Not Separately Reported on the NAIC Annual Statement.* Section V of Notice 88–100, 1988–2 C.B. 439, sets forth a composite method for computing discounted unpaid losses for accident years that are not separately reported on the annual statement. The tables separately provide discount factors for taxpayers who elect to use the composite method of section V of Notice 88–100. *See* Rev. Proc. 2002–74, 2002–51 I.R.B. 980.

(4) *Comments Requested on Smoothing Data*. In some cases, the methodology currently used to estimate unpaid losses and salvage patterns may produce negative discount factors, discount factors that exceed one, or large year-to-year differences in discount factors. (See, for example, the unpaid loss discount factors for Reinsurance C.) Notice 88–100, section IV, sets forth a methodology to replace such factors by a positive discount factor. Notice 88–100 does not extend this methodology to situations with positive, yet small, discount factors, discount factors in excess of one, or factors that change substantially from year to year. Comments are requested as to whether a methodology should be adopted to smooth the raw payment data and thus produce a more stable pattern of discount factors. Comments should be sent to CC:ITA:RU (Rev. Proc. 2003–17), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:ITA:RU (Rev. Proc. 2003–17), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. In the alternative, e-mail comments to *Notice.Comments@irscounsel.treas.gov.*

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount unpaid losses under § 846 for a line of business using the discount factors published by the Secretary.

SECTION 4. TABLES OF DISCOUNT FACTORS

.01 The following tables present separately for each line of business the discount factors under § 846 for accident year 2002. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2002, 5.71 percent, and by assuming all loss payments occur in the middle of the calendar year.

.02 If the groupings of individual lines of business on the annual statement change, taxpayers must discount unpaid losses on the resulting line of business in accordance with the discounting patterns that would have applied to those unpaid losses based on their classification on the 2002 annual statement.

.03 Tables

Accident and Health
(Other Than Disability Income or Credit Disability Insurance)

Taxpayers that do not use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the 2002 and later tax years.

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount all unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2002 tax year.

Auto Physical Damage

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	89.6468	89.6468	10.3532	10.0453	97.0259
2003	99.6845	10.0377	0.3155	0.2986	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	0.1578	0.1578	0.1534	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

Commercial Auto/Truck Liability/Medical

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	28.8244	28.8244	71.1756	63.9395	89.8335
2003	54.9871	26.1626	45.0129	40.6913	90.3990
2004	72.8039	17.8168	27.1961	24.6963	90.8082
2005	85.0572	12.2533	14.9428	13.5082	90.3992
2006	91.6276	6.5704	8.3724	7.5241	89.8680
2007	94.9514	3.3239	5.0486	4.5363	89.8537
2008	97.0453	2.0938	2.9547	2.6426	89.4349
2009	98.1574	1.1121	1.8426	1.6500	89.5481
2010	98.7370	0.5796	1.2630	1.1483	90.9194
2011	99.1070	0.3700	0.8930	0.8335	93.3331

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.3700	0.5230	0.5007	95.7246
2013 and later years	0.3700	0.1530	0.1488	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 96.4013 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Composite

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	40.9985	40.9985	59.0015	51.8901	87.9471
2003	65.8439	24.8454	34.1561	29.3081	85.8065
2004	77.5023	11.6583	22.4977	18.9950	84.4309
2005	84.6221	7.1198	15.3779	12.7594	82.9722
2006	90.2455	5.6234	9.7545	7.7062	79.0017
2007	92.2780	2.0325	7.7220	6.0566	78.4322
2008	94.3974	2.1195	5.6026	4.2232	75.3807
2009	95.2526	0.8552	4.7474	3.5851	75.5182
2010	96.2792	1.0266	3.7208	2.7343	73.4885
2011	96.4323	0.1531	3.5677	2.7330	76.6061

Composite

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.1531	3.4145	2.7317	80.0010
2013	0.1531	3.2614	2.7302	83.7124
2014	0.1531	3.1083	2.7286	87.7867
2015	0.1531	2.9551	2.7270	92.2803
2016 and later years	0.1531	2.8020	2.7253	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 88.0794 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Fidelity/Surety

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	38.3328	38.3328	61.6672	56.7940	92.0976
2003	58.8485	20.5156	41.1515	38.9437	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	20.5758	20.5758	20.0123	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

Financial Guaranty/Mortgage Guaranty

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	4.0723	4.0723	95.9277	88.7169	92.4831
2003	40.7639	36.6916	59.2361	56.0580	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	29.6180	29.6180	28.8070	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

International (Composite)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	40.9985	40.9985	59.0015	51.8901	87.9471
2003	65.8439	24.8454	34.1561	29.3081	85.8065
2004	77.5023	11.6583	22.4977	18.9950	84.4309
2005	84.6221	7.1198	15.3779	12.7594	82.9722
2006	90.2455	5.6234	9.7545	7.7062	79.0017
2007	92.2780	2.0325	7.7220	6.0566	78.4322
2008	94.3974	2.1195	5.6026	4.2232	75.3807
2009	95.2526	0.8552	4.7474	3.5851	75.5182
2010	96.2792	1.0266	3.7208	2.7343	73.4885
2011	96.4323	0.1531	3.5677	2.7330	76.6061

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.1531	3.4145	2.7317	80.0010
2013	0.1531	3.2614	2.7302	83.7124
2014	0.1531	3.1083	2.7286	87.7867
2015	0.1531	2.9551	2.7270	92.2803
2016 and later years	0.1531	2.8020	2.7253	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 88.0794 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Medical Malpractice — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	7.3447	7.3447	92.6553	80.0569	86.4030
2003	29.0191	21.6744	70.9809	62.3436	87.8315
2004	53.3108	24.2917	46.6892	40.9278	87.6600
2005	69.1517	15.8409	30.8483	26.9779	87.4534
2006	82.0981	12.9464	17.9019	15.2074	84.9486
2007	86.3995	4.3014	13.6005	11.6532	85.6826
2008	89.7111	3.3116	10.2889	8.9138	86.6354
2009	92.4688	2.7577	7.5312	6.5875	87.4691
2010	94.5163	2.0475	5.4837	4.8584	88.5983
2011	95.7635	1.2471	4.2365	3.8536	90.9614

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

Medical Malpractice — Claims-Made

2012	1.2471	2.9894	2.7914	93.3767
2013	1.2471	1.7422	1.6685	95.7688
2014 and later years	1.2471	0.4951	0.4815	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 93.3767 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Medical Malpractice — Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	0.8316	0.8316	99.1684	79.3040	79.9691
2003	7.4573	6.6257	92.5427	77.0201	83.2266
2004	23.5575	16.1002	76.4425	64.8645	84.8539
2005	41.0062	17.4487	58.9938	50.6283	85.8197
2006	55.5832	14.5770	44.4168	38.5318	86.7505
2007	68.9413	13.3581	31.0587	26.9978	86.9250
2008	78.2095	9.2682	21.7905	19.0102	87.2408
2009	82.8727	4.6632	17.1273	15.3012	89.3380
2010	86.3178	3.4451	13.6822	12.6328	92.3302
2011	91.0834	4.7656	8.9166	8.4543	94.8160

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012 and later years	4.7656	4.1510	4.0373	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.1845 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Miscellaneous Casualty

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	79.7790	79.7790	20.2210	19.2759	95.3259
2003	94.9417	15.1627	5.0583	4.7869	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	2.5292	2.5292	2.4599	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

Multiple Peril Lines
(Homeowners/Farmowners, Commercial Multiple Peril, and Special Liability
(Ocean Marine, Aircraft (All Perils), Boiler and Machinery))

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	59.7445	59.7445	40.2555	36.3785	90.3691
2003	81.0347	21.2902	18.9653	16.5661	87.3498
2004	87.3325	6.2978	12.6675	11.0369	87.1282
2005	91.0659	3.7334	8.9341	7.8286	87.6268
2006	95.1781	4.1122	4.8219	4.0477	83.9442
2007	95.7605	0.5824	4.2395	3.6800	86.8035
2008	97.0539	1.2933	2.9461	2.5604	86.9067
2009	97.6441	0.5903	2.3559	2.0997	89.1265
2010	98.7037	1.0596	1.2963	1.1302	87.1862
2011	98.6217	-0.0821	1.3783	1.2791	92.7987

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.5226	0.8558	0.8148	95.2164
2013 and later years	0.5226	0.3332	0.3240	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 95.2688 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Other (Including Credit)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	69.1729	69.1729	30.8271	29.3033	95.0568
2003	91.2168	22.0439	8.7832	8.3120	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	4.3916	4.3916	4.2714	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

Other Liability — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	14.9618	14.9618	85.0382	71.8257	84.4629
2003	36.2113	21.2494	63.7887	54.0793	84.7787
2004	54.2876	18.0763	45.7124	38.5820	84.4015
2005	64.2163	9.9288	35.7837	30.5767	85.4488
2006	73.2732	9.0569	26.7268	23.0108	86.0964
2007	80.5748	7.3016	19.4252	16.8175	86.5760
2008	87.6200	7.0452	12.3800	10.5343	85.0912
2009	89.9155	2.2955	10.0845	8.7757	87.0214
2010	93.3946	3.4791	6.6054	5.6997	86.2886
2011	94.6170	1.2223	5.3830	4.7684	88.5817

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	1.2223	4.1607	3.7839	90.9440
2013	1.2223	2.9383	2.7432	93.3586
2014	1.2223	1.7160	1.6431	95.7504
2015 and later years	1.2223	0.4936	0.4801	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 90.9440 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Other Liability — Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	19.1133	19.1133	80.8867	65.8673	81.4315
2003	36.4434	17.3301	63.5566	51.8103	81.5183
2004	52.1648	15.7215	47.8352	38.6046	80.7033
2005	63.2383	11.0734	36.7617	29.4237	80.0389
2006	72.0780	8.8397	27.9220	22.0152	78.8453
2007	75.9021	3.8241	24.0979	19.3405	80.2579
2008	82.9305	7.0284	17.0695	13.2186	77.4395
2009	85.1441	2.2136	14.8559	11.6974	78.7391
2010	89.3006	4.1565	10.6994	8.0918	75.6286
2011	89.9898	0.6892	10.0102	7.8453	78.3725

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

Other Liability — Occurrence

2012	0.6892	9.3210	7.5846	81.3711
2013	0.6892	8.6318	7.3090	84.6761
2014	0.6892	7.9426	7.0178	88.3566
2015	0.6892	7.2533	6.7099	92.5073
2016 and later years	0.6892	6.5641	6.3844	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 88.5630 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Private Passenger Auto Liability/Medical

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	43.1926	43.1926	56.8074	52.2499	91.9773
2003	72.2008	29.0082	27.7992	25.4085	91.4000
2004	84.5632	12.3625	15.4368	14.1488	91.6566
2005	91.9316	7.3684	8.0684	7.3809	91.4792
2006	95.8729	3.9413	4.1271	3.7501	90.8651
2007	97.7804	1.9075	2.2196	2.0030	90.2423
2008	98.7957	1.0153	1.2043	1.0735	89.1398
2009	99.2491	0.4535	0.7509	0.6686	89.0445
2010	99.5195	0.2703	0.4805	0.4288	89.2424
2011	99.6353	0.1159	0.3647	0.3342	91.6449

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.1159	0.2488	0.2342	94.1130
2013	0.1159	0.1330	0.1284	96.5863
2014 and later years	0.1159	0.0171	0.0166	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 95.0993 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Products Liability — Claims-Made

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	6.5804	6.5804	93.4196	75.6441	80.9723
2003	26.7183	20.1379	73.2817	59.2585	80.8639
2004	43.1834	16.4652	56.8166	45.7134	80.4579
2005	43.9209	0.7375	56.0791	47.5654	84.8185

Products Liability — Claims-Made

2006	54.3806	10.4597	45.6194	39.5272	86.6457
2007	78.3630	23.9824	21.6370	17.1267	79.1545
2008	82.8643	4.5013	17.1357	13.4765	78.6460
2009	68.2184	-14.6459	31.7816	29.3043	92.2052
2010	79.1582	10.9399	20.8418	19.7298	94.6644
2011	89.6963	10.5381	10.3037	10.0215	97.2617

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 90.3597 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Products Liability — Occurrence

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	9.4198	9.4198	90.5802	71.8513	79.3234
2003	20.5845	11.1647	79.4155	64.4750	81.1869
2004	36.7807	16.1962	63.2193	51.5043	81.4693
2005	55.5974	18.8167	44.4026	35.0987	79.0466
2006	66.6238	11.0263	33.3762	25.7661	77.1990
2007	77.2636	10.6399	22.7364	16.2979	71.6822
2008	79.1888	1.9251	20.8112	15.2492	73.2740
2009	83.6816	4.4928	16.3184	11.5007	70.4765
2010	85.5507	1.8691	14.4493	10.2356	70.8380
2011	85.7291	0.1784	14.2709	10.6366	74.5336

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.1784	14.0925	11.0605	78.4854
2013	0.1784	13.9141	11.5087	82.7124
2014	0.1784	13.7357	11.9824	87.2355
2015	0.1784	13.5573	12.4832	92.0772
2016 and later years	0.1784	13.3789	13.0126	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 87.5350 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Reinsurance A (Nonproportional Assumed Property)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	25.0571	25.0571	74.9429	67.5012	90.0701
2003	52.0402	26.9831	47.9598	43.6127	90.9360
2004	82.4709	30.4307	17.5291	14.8155	84.5198
2005	85.6387	3.1678	14.3613	12.4045	86.3747
2006	92.7228	7.0840	7.2772	5.8293	80.1036
2007	91.8604	-0.8624	8.1396	7.0488	86.5992
2008	96.5016	4.6412	3.4984	2.6795	76.5908
2009	96.1872	-0.3143	3.8128	3.1557	82.7657
2010	97.6206	1.4333	2.3794	1.8622	78.2609
2011	97.8419	0.2214	2.1581	1.7409	80.6694

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	0.2214	1.9367	1.6127	83.2710
2013	0.2214	1.7154	1.4772	86.1173
2014	0.2214	1.4940	1.3340	89.2892
2015	0.2214	1.2727	1.1826	92.9218
2016 and later years	0.2214	1.0513	1.0225	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 91.2226 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Reinsurance B (Nonproportional Assumed Liability)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	8.9223	8.9223	91.0777	71.5358	78.5436
2003	27.3618	18.4395	72.6382	56.6618	78.0055
2004	44.5758	17.2140	55.4242	42.1986	76.1374
2005	53.8781	9.3023	46.1219	35.0439	75.9810
2006	60.8896	7.0115	39.1104	29.8360	76.2865
2007	69.7327	8.8430	30.2673	22.4476	74.1644
2008	76.6292	6.8965	23.3708	16.6387	71.1942
2009	79.4030	2.7738	20.5970	14.7368	71.5484
2010	83.8936	4.4906	16.1064	10.9612	68.0553
2011	80.1707	-3.7229	19.8293	15.4148	77.7378

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

Reinsurance B (Nonproportional Assumed Liability)

2012	1.1805	18.6487	15.0812	80.8701
2013	1.1805	17.4682	14.7286	84.3167
2014	1.1805	16.2877	14.3559	88.1394
2015	1.1805	15.1072	13.9618	92.4186
2016 and later years	1.1805	13.9266	13.5453	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 90.3328 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Reinsurance C (Nonproportional Assumed Financial Lines)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	17.1195	17.1195	82.8805	71.6629	86.4654
2003	46.6590	29.5395	53.3410	45.3837	85.0823
2004	67.7135	21.0545	32.2865	26.3279	81.5446
2005	78.1379	10.4244	21.8621	17.1133	78.2786
2006	89.7346	11.5967	10.2654	6.1673	60.0786
2007	92.1268	2.3921	7.8732	4.0600	51.5667
2008	89.7323	-2.3945	10.2677	6.7537	65.7759
2009	90.0460	0.3137	9.9540	6.8167	68.4827
2010	94.8867	4.8407	5.1133	2.2290	43.5925
2011	86.7041	-8.1827	13.2959	10.7693	80.9970

Taxpayers that do not use the composite method of Notice 88-100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	1.4277	11.8683	9.9164	83.5537
2013	1.4277	10.4406	9.0147	86.3430
2014	1.4277	9.0129	8.0616	89.4449
2015	1.4277	7.5852	7.0540	92.9969
2016 and later years	1.4277	6.1575	5.9889	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 83.5537 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

Special Property
(Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	62.9320	62.9320	37.0680	35.1627	94.8599
2003	88.4950	25.5631	11.5050	10.8877	94.6349

Special Property
(Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2004 and later years	5.7525	5.7525	5.5950	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2004 tax year.

Workers' Compensation

Tax Year	Estimated Cumulative Losses Paid (%)	Estimated Losses Paid Each Year (%)	Unpaid Losses at Year End (%)	Discounted Unpaid Losses at Year End (%)	Discount Factors (%)
2002	28.2489	28.2489	71.7511	61.5953	85.8458
2003	57.8739	29.6249	42.1261	34.6534	82.2611
2004	71.2999	13.4260	28.7001	22.8281	79.5402
2005	77.7584	6.4585	22.2416	17.4913	78.6421
2006	81.9301	4.1717	18.0699	14.2009	78.5885
2007	83.7739	1.8437	16.2261	13.1161	80.8329
2008	86.5350	2.7611	13.4650	11.0261	81.8872
2009	88.4367	1.9017	11.5633	9.7005	83.8901
2010	89.5926	1.1559	10.4074	9.0659	87.1103
2011	91.6441	2.0515	8.3559	7.4743	89.4497

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount unpaid losses that are incurred in this line of business in the 2002 accident year and that are outstanding at the end of the tax year shown.

2012	2.0515	6.3045	5.7919	91.8701
2013	2.0515	4.2530	4.0134	94.3668
2014	2.0515	2.2016	2.1334	96.9035
2015 and later years	2.0515	0.1501	0.1460	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 89.5412 percent to discount unpaid losses that are incurred in this line of business in 2002 and that are outstanding at the end of the 2012 tax year.

DRAFTING INFORMATION

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, sections 832, 846; 1.832–4, 1.846–1.)

Rev. Proc. 2003–18

SECTION 1. PURPOSE

This revenue procedure prescribes the salvage discount factors for 2002. These factors must be used to compute discounted estimated salvage recoverable under § 832 of the Internal Revenue Code.

SECTION 2. BACKGROUND

Section 832(b)(5)(A) requires that all estimated salvage recoverable (including that which cannot be treated as an asset for state accounting purposes) be taken into account in computing the deduction for losses incurred. Under § 832(b)(5)(A), paid losses are reduced by salvage and reinsurance recovered during the taxable year. This amount is adjusted to reflect changes in discounted unpaid losses on nonlife insur-

ance contracts and in unpaid losses on life insurance contracts. An adjustment is then made to reflect any changes in discounted estimated salvage recoverable and in reinsurance recoverable.

Pursuant to § 832(b), the amount of estimated salvage is determined on a discounted basis in accordance with procedures established by the Secretary.

SECTION 3. SCOPE

This revenue procedure applies to any taxpayer that is required to discount estimated salvage recoverable under § 832.

SECTION 4. APPLICATION

.01 The following tables present separately for each line of business the discount factors under § 832 for 2002. All the discount factors presented in this section were determined using the applicable interest rate under § 846(c) for 2002, which is 5.71 percent, and by assuming all estimated salvage is recovered in the middle of the calendar year

.02 Section V of Notice 88–100, 1988–2 C.B. 439, sets forth a composite method for computing discounted unpaid losses for accident years that are not separately reported on the annual statement. Rev. Proc. 2002–74, section 3.03, 2002–51 I.R.B. 980, provides that an insurance company that elects to use the composite method of Notice 88–100 must use the same method to compute discounted estimated salvage recoverable. Accordingly, the tables separately provide discount factors for taxpayers who elect to use the composite method of section V of Notice 88–100.

.03 These tables must be used by taxpayers irrespective of whether they elected to discount unpaid losses using their own experience under § 846(e).

.04 Tables.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Taxpayers that do not use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2002 and later taxable years with respect to losses incurred in this line of business in 2002.

Accident and Health (Other Than Disability Income or Credit Disability Insurance)

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2002 with respect to losses incurred in this line of business in 2002.

Auto Physical Damage

Tax Year	Discount Factors (%)
2002	95.9613
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Commercial Auto/Truck Liability/Medical

Tax Year	Discount Factors (%)
2002	89.1648
2003	88.8184
2004	88.5411
2005	89.1228
2006	89.7404
2007	89.0554
2008	90.5327
2009	91.8164
2010	92.1496
2011	94.6715

Commercial Auto/Truck Liability/Medical

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2211 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Composite

Tax Year	Discount Factors (%)
2002	89.0851
2003	87.5364
2004	86.9084
2005	86.1903
2006	84.7791
2007	84.8602
2008	84.5391
2009	84.4628
2010	84.5889
2011	86.8329

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	89.1538
2013	91.5493
2014	94.0070
2015	96.4596
2016 and later years	97.2617

Composite

Taxpayers that use the composite method of Notice 88–100 should use 92.5879 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Fidelity/Surety

Tax Year	Discount Factors (%)
2002	92.0133
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Financial Guaranty/Mortgage Guaranty

Tax Year	Discount Factors (%)
2002	93.7635
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Financial Guaranty/Mortgage Guaranty

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

International (Composite)

Tax Year	Discount Factors (%)
2002	89.0851
2003	87.5364
2004	86.9084
2005	86.1903
2006	84.7791
2007	84.8602
2008	84.5391
2009	84.4628
2010	84.5889
2011	86.8329

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	89.1538
2013	91.5493
2014	94.0070
2015	96.4596
2016 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 92.5879 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Medical Malpractice — Claims-Made

Tax Year	Discount Factors (%)
2002	83.3446
2003	77.4565
2004	83.3469
2005	80.3314
2006	81.5320
2007	74.4259
2008	86.8875
2009	90.5735
2010	95.0023
2011	97.2617

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Medical Malpractice — Occurrence

Tax Year	Discount Factors (%)
2002	78.2595
2003	79.6832
2004	84.2125
2005	86.0904
2006	70.2129
2007	82.8072
2008	89.2934
2009	93.1674
2010	95.3914
2011	97.2617

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

Medical Malpractice — Occurrence

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.1286 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Miscellaneous Casualty

Tax Year	Discount Factors (%)
2002	95.3528
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Multiple Peril Lines (Homeowners/ Farmowners, Commercial Multiple Peril, and Special Liability (Ocean Marine, Aircraft (All Perils), Boiler and Machinery))

Tax Year	Discount Factors (%)
2002	90.2539
2003	88.1069
2004	89.0426
2005	88.6765
2006	88.1493
2007	89.7100
2008	89.7645
2009	89.9881
2010	91.9392
2011	94.4458

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	97.0065
2013 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.0065 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Other (Including Credit)

Tax Year	Discount Factors (%)
2002	95.5983
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Other (Including Credit)

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Other Liability — Claims-Made

Tax Year	Discount Factors (%)
2002	88.5534
2003	77.0799
2004	59.8423
2005	85.1827
2006	80.6863
2007	79.6704
2008	87.4045
2009	91.7825
2010	87.7798
2011	90.1269

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	92.5413
2013	94.9916
2014 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 92.5413 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Other Liability — Occurrence

Tax Year	Discount Factors (%)
2002	82.1003
2003	83.8238
2004	85.1543

Other Liability — Occurrence

2005	81.0240
2006	85.2626
2007	88.2873
2008	88.7248
2009	91.2567
2010	92.8723
2011	95.2829

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Private Passenger Auto Liability/Medical

Tax Year	Discount Factors (%)
2002	92.6794
2003	92.4436
2004	92.1118
2005	91.1168
2006	90.8537
2007	89.5944
2008	89.5168
2009	89.5750
2010	91.0294
2011	93.4478

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

Private Passenger Auto Liability/Medical

2012	95.8417
2013 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 96.2722 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Products Liability — Claims-Made

Tax Year	Discount Factors (%)
2002	83.8918
2003	83.9617
2004	85.9812
2005	80.9402
2006	75.8992
2007	83.6008
2008	89.1426
2009	94.2722
2010	12.7896
2011	94.7448

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Products Liability — Occurrence

Tax Year	Discount Factors (%)
2002	77.1249
2003	80.2580
2004	80.9969
2005	84.1881
2006	81.0130
2007	85.2160
2008	88.9333
2009	89.8343
2010	83.2562
2011	85.4521

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	87.7240
2013	90.0713
2014	92.4880
2015	94.9465
2016 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 89.9396 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Reinsurance A (Nonproportional Assumed Property)

Tax Year	Discount Factors (%)
2002	83.0276
2003	79.4487
2004	84.3983
2005	88.9304
2006	89.6909
2007	91.8095
2008	93.9748
2009	95.5166

Reinsurance A (Nonproportional Assumed Property)

2010	96.2373
2011	97.2617

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Reinsurance B (Nonproportional Assumed Liability)

Tax Year	Discount Factors (%)
2002	82.5422
2003	79.7782
2004	83.6886
2005	81.1133
2006	72.7512
2007	76.9860
2008	76.1494
2009	78.8202
2010	72.6244
2011	81.6711

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012	84.1450
2013	86.8254
2014	89.7871
2015	93.1686
2016 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 90.7865 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Reinsurance B (Nonproportional Assumed Liability)

Tax Year	Discount Factors (%)
2002	82.1001
2003	82.9712
2004	87.1724
2005	84.0362
2006	87.9032
2007	79.5172
2008	83.3178
2009	91.6271
2010	93.2736
2011	95.6650

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2012 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

Special Property (Fire, Allied Lines, Inland Marine, Earthquake, Glass, Burglary and Theft)

Tax Year	Discount Factors (%)
2002	92.5352
2003	94.6349

Taxpayers that do not use the composite method of Notice 88–100 should use the following factor to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

2004 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 97.2617 percent to discount estimated salvage recoverable as of the end of 2004 with respect to losses incurred in this line of business in 2002.

Workers' Compensation

Tax Year	Discount Factors (%)
2002	83.1651
2003	84.7058
2004	85.2400
2005	85.1429
2006	84.3224
2007	85.3097
2008	85.0472
2009	85.2314
2010	86.2035
2011	88.4933

Taxpayers that do not use the composite method of Notice 88–100 should use the following factors to discount estimated salvage recoverable as of the end of the tax year shown with respect to losses incurred in this line of business in 2002.

Workers' Compensation

2012	90.8522
2013	93.2636
2014	95.6550
2015 and later years	97.2617

Taxpayers that use the composite method of Notice 88–100 should use 93.1315 percent to discount estimated salvage recoverable as of the end of 2012 with respect to losses incurred in this line of business in 2002.

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine A. Hossofsky of the Office of the Associate Chief Counsel (Financial Institutions and Products). For further information regarding this revenue procedure, contact Ms. Hossofsky at (202) 622–3477 (not a toll-free call).

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part 1, §§ 263A, 446, 471, 472, 481, 7121; 1.263A–1, 1.446–1, 1.471–2, 1.471–4, 1.472–2, 1.481–1.)

Rev. Proc. 2003–20

SECTION 1. PURPOSE

This revenue procedure provides a safe harbor method of accounting (the "Core Alternative Valuation" (CAV) method) for remanufacturers and rebuilders of motor vehicle parts ("remanufacturers") and resellers of remanufactured and rebuilt motor vehicle parts ("resellers") that use the lower of cost or market (LCM) inventory valuation method to value their inventory of cores held for remanufacturing or sale. The CAV method is provided by the Commissioner pursuant to his authority under § 446 of the Internal Revenue Code in order to minimize disputes, provide certainty, and simplify inventory computations. This revenue procedure also provides a procedure for qualifying remanufacturers and resellers currently using an LCM method to obtain automatic consent of the Commissioner to change to the CAV method. In addition, this revenue procedure provides a procedure for qualifying remanufacturers and resellers not currently using an LCM method to obtain automatic consent to change to an LCM method in conjunction with a change to the CAV method.

SECTION 2. BACKGROUND

.01 *In General.*

(1) Remanufacturers acquire inventories of used motor vehicle parts (*e.g.*, wiper motors, engines, transmissions, and alternators for automobiles, trucks, buses, etc.) for use in remanufacturing. These used parts are frequently referred to within the remanufacturing industry as "cores." Remanufacturers rebuild motor vehicle parts from cores through use of new and used component parts and sell the resulting products as remanufactured replacement parts. Resellers acquire cores in conjunction with their resale activity and sell the cores to a remanufacturer or another reseller in the distribution chain.

(2) Remanufacturers and resellers acquire cores from customers ("customer cores") who purchase remanufactured replacement parts. To encourage a customer to return the core, remanufacturers and resellers generally offer the customer a credit (offset against the purchase price). Remanufacturers and resellers also acquire cores from third-party suppliers of cores (businesses that specialize in supplying cores to meet specific needs, referred to within the industry as "core suppliers" or "core brokers") and occasionally acquire cores directly from other sources.

(3) Controversy exists as to the proper market valuation of cores under the LCM method. *See Consolidated Manufacturing, Inc. v. Commissioner*, 249 F.3d 1231 (10th Cir. 2001), *rev'g in part*, 111 T.C. 1 (1998). In order to reduce controversy and minimize disputes, the Service has determined that it is appropriate to provide a safe harbor procedure for the LCM valuation of cores in inventory.

.02 Section 471 of the Internal Revenue Code, which governs the treatment of inventories, provides two tests to which each inventory must conform: (1) it must conform as nearly as may be to the best accounting practice in the trade or business; and (2) it must clearly reflect income. Section 1.471–2(c) of the Income Tax Regulations provides that the bases of valuation most commonly used by business concerns and which meet the requirements of § 471 are (1) cost and (2) cost or market, whichever is lower. Section 1.471–2(c) also provides that any goods in an inventory that are unsalable at normal prices or unusable in the normal way because of damage, imperfections, shop wear, changes of style, odd or broken lots, or other similar causes, including second-hand goods taken in exchange, should be valued, if such goods consist of raw materials held for use or consumption, upon a reasonable basis taking into consideration the usability and condition of the goods, but in no case shall such value be less than the scrap value.

.03 Section 1.471–3(b) defines the cost of merchandise purchased since the beginning of the taxable year as the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted, or not, at the option of the taxpayer, provided the taxpayer follows a consistent course. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods. In the case of merchandise produced by the taxpayer, § 1.471–3(c) defines cost as (1) the cost of raw materials and supplies entering into or consumed in connection with the product, (2) expenditures for direct labor, and (3) indirect production costs incident to, and necessary for, the production of the particular article, including in such indirect production costs an appropriate portion of management expenses, but not including any cost of selling or return on capital, whether by way of interest or profit. *See* §§ 1.263A–1 and 1.263A–2 for more specific rules regarding the treatment of production costs.

.04 Section 1.471–4(a) provides that, under ordinary circumstances and for normal goods in inventory, "market" means the aggregate of the current bid prices prevailing at the date of the inventory of the basic elements of cost reflected in inventories of goods purchased and on hand, goods in process of manufacture, and finished manufactured goods on hand. The basic elements of cost include direct materials, direct labor, and indirect costs required to be included in inventories by the taxpayer (*e.g.*, under § 263A and its underlying regulations for taxpayers subject to that section). For taxpayers to which § 263A applies, for example, the basic elements of cost must reflect all direct costs and all indirect costs properly allocable to goods on hand at the inventory date at the current bid price of

those costs, including but not limited to the cost of purchasing, handling, and storage activities conducted by the taxpayer, both prior to and subsequent to acquisition or production of the goods.

.05 Section 1.471–4(c) provides that if inventory is valued upon the basis of cost or market, whichever is lower, the market value of each article on hand at the inventory date shall be compared with the cost of the article, and the lower of such values shall be taken as the inventory value of the article.

.06 Section 1.471–2(f) provides deducting from inventory a reserve for price changes, or an estimated depreciation in the value of the inventory, is not in accord with the regulations underlying § 471.

.07 Section 472(b) and § 1.472–2 require taxpayers using the last-in, first-out (LIFO) method to inventory their goods at cost.

.08 Section 446(e) and § 1.446–1(e)(2)(i) require that, except as otherwise expressly provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the terms and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

SECTION 3. SCOPE

.01 *Applicability.* This revenue procedure applies to remanufacturers and resellers that want to change to the CAV method described in section 4 of this revenue procedure to value inventories of cores. For purposes of this revenue procedure, "cores" include electrical, mechanical, hydraulic, and other operating motor vehicle parts, including parts of automobiles, trucks, buses, motorcycles, boats, construction equipment, farm machinery, and other on- and off-road motorized equipment. The CAV method applies only to cores held in inventory for remanufacturing or, in the case of a reseller, held for sale to a remanufacturer or another entity in the distribution chain. The CAV method only applies to cores valued under the LCM method.

.02 *Inapplicability.* This revenue procedure does not apply to a taxpayer that values its inventory of cores at cost (including a taxpayer using the LIFO method) unless the taxpayer concurrently changes (under section 6.02 of this revenue procedure) from cost to the LCM method for its cores (including labor and overhead related to the cores in raw materials, work-in-process and finished goods). A taxpayer that wants to concurrently change from cost to the LCM method must: (a) not be otherwise prohibited from using the LCM method; (b) comply with the general rules relating to inventories under § 471 and the regulations thereunder; and (c) in the case of taxpayers using the LIFO method, use the LCM method and a permitted method for identification as determined and defined in section 10.01(1)(b) of the APPENDIX of Rev. Proc. 2002–9, 2002–3 I.R.B. 327, 368–69.

SECTION 4. THE CORE ALTERNATIVE VALUATION METHOD

.01 *In General.*

(1) A taxpayer using the CAV method values its inventory of cores at LCM, determines cost in accordance with section 4.02 of this revenue procedure, and determines market in accordance with section 4.03 of this revenue procedure.

(2) The CAV method will be a permissible method of accounting provided the taxpayer follows the rules and computational methodology described in sections 4.02 through 4.05 of this revenue procedure and, if the taxpayer is changing from another method to the CAV method, the provisions of section 6 of this revenue procedure regarding changes in method of accounting. All computations under the CAV method, however, are subject to verification upon examination of the taxpayer's income tax returns.

.02 *Determination of Cost.*

(1) *In general.* Under the CAV method, the taxpayer is required to use as the cost of each core in ending inventory the invoice price adjusted, as appropriate, for discounts, freight costs, and other direct and indirect costs properly allocable to the cores as described in §§ 1.471–3 and 1.263A–1. If the core was acquired from a core supplier or broker, the invoice price is the amount paid to the core supplier or broker. If the core was acquired from a customer, the invoice price is the sum of any credit allowed to the customer and any amount paid to the customer. *Consolidated Manufacturing, Inc. v. Commissioner*, 249 F.3d 1231 (10th Cir. 2001), *aff'd on this issue*, 111 T.C. 1 (1998).

(2) *Service may redetermine appropriate cost.* As a general rule, the taxpayer must follow the form that the taxpayer used for the transaction. *See*, for example, *In re Steen*, 509 F.2d 1398, 1402 n.4 (9th Cir. 1975) and *Commissioner v. Danielson*, 378 F.2d 771, 775 (3d Cir. 1967). If the Service determines, however, that the taxpayer's use of the credit amount as the invoice price does not clearly reflect income (for example, because the taxpayer artificially inflated both the price of the remanufactured core and the credit amount solely to manipulate gross receipts for tax avoidance), the Service may examine the substance of the transaction to determine the appropriate cost for a core. *See*, for example, *Gregory v. Helvering*, 293 U.S. 465, 55 S. Ct. 266, 79 L. Ed. 596 (1935).

.03 *Determination of Market Value.*

(1) *In general*. Under the CAV method, the market value under § 1.471–4 of each core in ending inventory is the "allowable supplier price" adjusted, as appropriate, for other direct and indirect costs properly allocable to the core as described in §§ 1.471–4 and 1.263A–1. The allowable supplier price will be considered to be the replacement cost for purposes of §§ 1.471–4 and 1.263A–1.

(2) *Allowable supplier price.* For purposes of this revenue procedure the "allowable supplier price" is the amount the taxpayer would pay in an arm's length transaction to acquire a particular core from a core supplier or core broker, plus the related transportation cost that would be incurred to acquire possession of the core from the core broker or supplier at year-end. If the taxpayer has purchased a particular type of core from several core suppliers or core brokers during the tax year, the allowable supplier price for that core type will be deemed to be the weighted-average price, including transportation cost, the taxpayer would have to pay in an arm's length transaction to acquire the particular core type at year-end from the core suppliers or core brokers from whom the cores were purchased during the tax year. If the taxpayer has not purchased a particular core type from a core supplier or core broker during the tax year, the taxpayer must identify its largest (in dollar terms) supplier of cores during the current tax year that also sells the particular core type in the ordi-

nary course of its business; the allowable supplier price will be the arm's length price from that supplier for the core type at year-end plus the transportation cost that would be incurred to acquire the core type from that supplier. If none of the taxpayer's suppliers sell the particular core type, the taxpayer must reasonably determine the allowable supplier price based on the arm's length price for the core type at year-end, plus the transportation cost, in the geographical area or market in which the taxpayer regularly participates. In any case, no further adjustments will be allowed in determination of allowable supplier price.

(3) *Example of allowable supplier price calculation using weighted-average price*. Taxpayer, a remanufacturer, had 4 units of Part X customer cores in inventory at year-end. Taxpayer acquired these customer cores from customers in transactions in which taxpayer sold to the customers remanufactured parts and received cores from the customers in exchange for credits toward the purchase price of the remanufactured parts. During the tax year, Taxpayer purchased 8 units of Part X cores from suppliers (2 units of Part X from Core Supplier A and 6 units of Part X from Core Supplier B). Therefore, Taxpayer purchased 25% (2 of 8 units) of the total number of Part X acquired for the year from Core Supplier A and 75% (6 of 8 units) of the total number of Part X acquired for the year from Core Supplier B. At the end of the taxable year, the price Taxpayer would have to pay in an arm's length transaction to acquire Part X, including transportation cost, was $20 from Core Supplier A and $16 from Core Supplier B. Taxpayer would determine the allowable supplier price for Part X customer cores under the CAV method as follows:

	# of Units Purchased During Year	% of Total Units Purchased During Year	End of Year Price
Core Supplier A	2	25%	$20
Core Supplier B	6	75%	$16
Total	8		

CAV Core Supplier Price for Part X Customer Cores = (25% x $20) + (75% x 16) = $17.

.04 *Comparison of Cost and Market.* Under the CAV method, the market value of each core in ending inventory, as determined under section 4.03 of this revenue procedure, shall be compared with the cost of each core in ending inventory, as determined under section 4.02 of this revenue procedure, and the lower of such values shall be the inventory value of the core. This analysis must be performed on a part-by-part basis.

.05 *Write-down of Defective Cores*. Under the CAV method, a taxpayer may not reduce the value of a defective core under § 1.471–2(c) until the taxpayer discovers that the core is subnormal and scraps the core or offers the core for sale at a *bona fide* selling price that is less than cost. In no case may a taxpayer value a core at less than the scrap value. A taxpayer may not reduce the value of cores based on anticipated defect percentages or historical defect experience rates. If a taxpayer complies with the requirements of this revenue procedure, the Service will not disallow a write-down of a defective core in the year it is scrapped on the grounds that the decline in the value of the core actually occurred in a preceding taxable year.

SECTION 5. AUDIT PROTECTION FOR TAXPAYERS CURRENTLY USING THE SAFE HARBOR METHOD

If a taxpayer within the scope of this revenue procedure was consistently using the CAV method provided in section 4 of this revenue procedure before February 10, 2003, the taxpayer's use of the CAV method will not be raised by the Service as an issue in a taxable year that ends before February 10, 2003. Moreover, if such taxpayer's use of the CAV method has already been raised as an issue in examination, appeals, or before the Tax Court in a taxable year that ends before February 10, 2003, the issue will not be further pursued by the Service.

SECTION 6. CHANGES IN METHOD OF ACCOUNTING

.01 *In General*. A change in the treatment of customer cores in inventory to the CAV method provided by this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. Therefore, a taxpayer within the scope of this revenue procedure that wishes to change to the CAV method for a taxable year ending on or after December 31, 2002, must file a Form 3115, *Application for Change in Accounting Method.*

.02 *Automatic Change for Taxpayers Within the Scope of this Revenue Procedure.*

(1) *Automatic change to the CAV method.* A taxpayer within the scope of this revenue procedure that wants to change to the CAV method must follow the automatic change in accounting method provisions of Rev. Proc. 2002–9, as modified by Rev. Proc. 2002–19, 2002–13 I.R.B. 696, Announcement 2002–17, 2002–8 I.R.B. 561, and Rev. Proc. 2002–54, 2002–35 I.R.B. 432, with the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 2002–9 do not apply to a taxpayer that wants to change to the CAV method for its first taxable year ending on or after December 31, 2002, provided the taxpayer's method of accounting for cores is not an issue under consideration in examination (within the meaning of section 3.09 of Rev. Proc. 2002–9) at the time the Form 3115 is filed with the national office;

(b) In lieu of the label required by section 6.02(4) of Rev. Proc. 2002–9, taxpayers are instructed to write "Filed under Rev. Proc. 2003–20" at the top of the form; and

(c) Taxpayers making concurrent changes under subsections (2) or (3) of this section should include the concurrent change with the change to the CAV method in a single application.

(2) *Change from cost to LCM*. An automatic change in method of accounting to the CAV method under this revenue procedure also includes, where applicable, a concurrent change from the cost method to the LCM method.

(3) *Change from LIFO*. An automatic change in method of accounting to the CAV method under this revenue procedure also includes a concurrent change from the LIFO method to a permitted method for identification as determined and defined in section 10.01(1)(b) of the APPENDIX of Rev. Proc. 2002–9. A taxpayer that desires to discontinue LIFO to use the CAV method must make a concurrent change from its cost method to the LCM method.

SECTION 7. RECORD KEEPING

Section 6001 provides that every person liable for any tax imposed by the Code, or for the collection thereof, must keep such records, render such statements, make such returns, and comply with such rules and regulations as the Secretary may from time to time prescribe. The books or records required by § 6001 must be kept at all times available for inspection by authorized internal revenue officers or employees, and must be retained so long as the contents thereof may become material in the administration of any internal revenue law. § 1.6001–1(e). In order to satisfy the record keeping requirements of § 6001 and the regulations thereunder, a taxpayer that uses the CAV method should maintain records supporting all aspects of its inventory valuation including but not limited to cost of supplier cores.

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002–9 is modified and amplified to include this automatic change in section 9 of the APPENDIX.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2002.

SECTION 10. DRAFTING INFORMATION

The principal authors of this revenue procedure are Willie E. Armstrong, Jr. and W. Thomas McElroy, Jr. of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Armstrong or Mr. McElroy at (202) 622–4970 (not a toll free-call).

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26 CFR 601.602: Forms and instructions. (Also, Part 1, section 6033, 1.6033–2.)

Rev. Proc. 2003–21

SECTION 1. PURPOSE

This revenue procedure supplements Rev. Proc. 83–23, 1983–1 C.B. 687, by relieving certain United States possession organizations (other than private foundations) from the requirement of having to file an annual information return on Form 990, *Return of Organization Exempt From Income Tax*.

SECTION 2. BACKGROUND

.01 Section 6033(a)(1) of the Internal Revenue Code states that, with certain exceptions, every organization exempt from taxation under section 501(a) shall file an annual information return.

.02 Section 6033(a)(2)(B) of the Code provides that the Secretary may relieve any organization from the requirement to file a return if the Secretary determines that such filing is not necessary to the efficient administration of the internal revenue laws. Section 1.6033–2(g)(6) of the Income Tax Regulations delegates this authority to the Commissioner.

.03 Rev. Proc. 83–23, 1983–1 C.B. 687, lists certain classes or groups of organizations described in section 501(c) of the Code and exempt from tax under section 501(a) that are not required to file an annual information return on Form 990. The list of organizations that are not required to file an annual information return includes, for tax years ending on or after December 31, 1982, any organization (other than a private foundation) that normally has annual gross receipts of not more than $25,000. Rev. Proc. 94–17, 1994–1 C.B. 579, relieves certain foreign organizations (other than private foundations) from the requirement to file an annual return on Form 990. However, neither revenue procedure addresses organizations formed in United States possessions. Further, these revenue procedures do not distinguish between receipts from sources within the United States and from sources within United States possessions.

.04 Sections 861 through 865 of the Code and the regulations thereunder describe what types of income will be treated as income from sources within the United States.

.05 Section 7701(a)(9) of the Code defines "United States" when used in a geographical sense as only the States and the District of Columbia.

.06 Section 7701(a)(30) of the Code defines "United States person" as a citizen or resident of the United States, a domestic partnership, a domestic corporation, any estate that is not a foreign estate (within the meaning of section 7701(a)(31) of the Code), or any trust if "(i) a court within the United States is able to exercise primary supervision over the administration of the trust, and (ii) one or more United States persons have the authority to control all substantial decisions of the trust."

.07 For purposes of this revenue procedure, a "United States possession organization" is any organization created or organized in a possession of the United States.

.08 A number of organizations formed in United States possessions have asked the Service for relief from filing Form 990 similar to the relief offered to foreign organizations. Because they do not have more than $25,000 in receipts from United States sources and no significant activity in the United States, the organizations believe the filing serves no useful purpose for tax administration but imposes a significant burden on the affected organizations.

SECTION 3. SCOPE

This revenue procedure applies to United States possession organizations exempt under section 501(a) of the Code (other than private foundations) that normally do not have more than $25,000 in annual gross re-

ceipts from sources within the United States and have no significant activity in the United States. For purposes of the preceding sentence: (i) the tests set forth in section 5 of Revenue Procedure 83–23 apply to determine whether the annual gross receipts of an organization are not normally more than $25,000; (ii) an organization's gifts, grants, contributions and membership fees are considered to be from sources within the United States only if they are received directly or indirectly from a United States person, as defined in section 7701(a)(30) of the Code; for purposes of this provision, amounts received from individuals who are *bona fide* residents of a United States possession will not be considered to be from a United States person; and (iii) the source of an organization's other gross receipts is determined by applying rules provided in sections 861 through 865 of the Code and the regulations thereunder (relating to the source of taxable income).

SECTION 4. PROCEDURE

.01 A United States possession organization (other than a private foundation) otherwise required to file Form 990 will be relieved from the filing requirement for any year in which it meets the following conditions:

(1) it normally does not receive more than $25,000 in gross receipts annually, as defined in section 5 of Rev. Proc. 83–23, from: (i) gifts, grants, contributions and membership fees received directly or indirectly from a United States person as defined in section 7701(a)(30) of the Code; for purposes of this provision a United States person does not include individuals who are *bona fide* residents of a United States possession; and (ii) other gross receipts from sources in the United States as determined under rules provided in sections 861 through 865 of the Code and the regulations thereunder; and

(2) it has no significant activity in the United States, as "United States" is defined in section 7701(a)(9) of the Code. For these purposes, the term "activity" includes lobbying and political activity and the operation of a trade or business, but does not include investment activity.

.02 If at any time an organization ceases to meet one or both of the conditions described in section 4.01, the organization is required to file the annual information return for the year in which it first ceased to qualify for relief under this procedure and for all subsequent years in which the organization does not qualify.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 83–23 is hereby supplemented.

SECTION 6. EFFECTIVE DATE

This revenue procedure applies for tax years ending on or after December 31, 2002.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Mary Jo Salins of Exempt Organizations Rulings and Agreements. For further information regarding this revenue procedure, contact Ms. Salins at (202) 283–9453 (not a toll-free call).

Part IV. Items of General Interest

Reductions of Accruals and Allocations Because of the Attainment of any Age; Application of Nondiscrimination Cross-Testing Rules to Cash Balance Plans; Hearing

Announcement 2003–6

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Change in date and location for public hearing on proposed rulemaking.

SUMMARY: This document provides notice of a change of date and location for the public hearing on proposed regulations (REG–209500–86; REG–164464–02, 2003–2 I.R.B. 262) under sections 401 and 411 regarding the requirements that accruals or allocations under certain retirement plans not cease or be reduced because of the attainment of any age.

DATES: The public hearing is being held on Wednesday, April 9, 2003, at 10 a.m. Outlines of oral comment must be received by Thursday, March 13, 2003.

ADDRESSES: The public hearing is being held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Send submissions to: CC:PA:RU (REG–209500–86 and REG–164464–02), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to: CC:PA:RU (REG–209500–86 and REG–164464–02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit outlines of oral comment electronically directly to the IRS Internet site at *www.irs.gov/regs*.

FOR FURTHER INFORMATION: Concerning the regulations, Linda Marshall (202) 622–6090; concerning submissions, Sonya M. Cruse (202) 622–7180 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

A notice of proposed rulemaking and notice of public hearing, appearing in the **Federal Register** on Wednesday, December 11, 2002 (67 FR 76123), announced that a public hearing on proposed regulations relating to the requirements that accruals or allocations under certain retirement plans not cease or be reduced because of the attainment of any age would be held on Thursday, April 10, 2003, in room 4718, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Subsequently, the date and location of the public hearing has been changed to Wednesday, April 9, 2003, in the auditorium. Outlines of oral comment must be received by Thursday, March 13, 2003.

Cynthia E. Grigsby,
Chief Regulations Unit,
Associate Chief Counsel
(Procedure and Administration).

(Filed by the Office of the Federal Register on January 16, 2003, 8:45 a.m., and published in the issue of the Federal Register for January 17, 2003, 68 F.R. 2466)

Information Reporting Relating to Acquisitions of Control and Substantial Changes in Capital Structure

Announcement 2003–7

For transactions occurring in 2002, corporations and brokers shall furnish a letter in lieu of Form 1099–CAP.

SECTION 1. BACKGROUND

On November 18, 2002, the Internal Revenue Service issued temporary regulations under section 6043(c) and 6045 (T.D. 9022, 2002–48 I.R.B. 909 [67 FR 69468]). These regulations require information reporting if a domestic corporation undergoes an acquisition of control or a substantial change in capital structure after December 31, 2001, and gain (if any) is required to be recognized due to the application of section 367(a) as a result of the transaction. In such case, the regulations require the corporation to file Form 8806 (or interim statement) describing the transaction to the Service. In addition, the regulations require the corporation to file Form 1099–CAP with the Service with respect to each shareholder of record that is not an exempt recipient and to furnish the Form 1099–CAP to each such shareholder. The regulations also require a broker, that holds stock in the corporation on behalf of actual owners, to file Form 1099–CAP with the Service with respect to each actual owner and to furnish Form 1099–CAP to each such owner. For transactions occurring in 2002, corporations must furnish Form 1099–CAP to shareholders on or before January 31, 2003, and brokers must furnish Form 1099–CAP to actual owners on or before February 28, 2003.

SECTION 2. PENALTY WAIVER

The Service recognizes that sufficient time is necessary for affected corporations and brokers to establish systems needed to capture and report the information required by the temporary regulations. Therefore, for transactions occurring in 2002, the Service will not impose penalties on corporations and brokers that comply with the requirements in the transition rules below.

SECTION 3. TRANSITION RULES FOR CORPORATIONS FOR TRANSACTIONS OCCURRING IN 2002

.01 A corporation that undergoes an acquisition of control or a substantial change in capital structure (as defined in section 1.6043–4T(c) and (d), respectively) during 2002 for which gain (if any) is required to be recognized due to the application of section 367(a) will satisfy the requirement to furnish Form 1099–CAP to each shareholder of record that is not an exempt recipient (as defined in section 1.6043–4T(b)(6)) by instead furnishing a letter to such shareholder that contains the following language:

> On [date], you exchanged shares in [name of corporation] for new shares [and cash and other property] in a transaction that may be subject to United States federal income tax due to the application of section 367(a) of the Internal Revenue Code. Depending on your

individual circumstances, you may be required to report any gain from the exchange on your federal income tax return. You had gain from the exchange if [the cash and] the fair market value on [the date of the exchange] of the new shares [and any other property] you received exceeded your basis in the shares of [name of corporation] that you gave up in the exchange. You are not permitted to claim a loss on your tax return with respect to the exchange.

The legend "Important Tax Return Document Enclosed" must appear in a bold and conspicuous manner on the outside of the envelope containing the letter. The letter must be furnished to the shareholder on or before February 15, 2003.

.02 The corporation is required to file an interim statement with the Service in accordance with section 1.6043–4T(a).

.03 Upon inquiry by a shareholder of record on the date of the transaction (including any clearing organization or broker), the corporation must identify itself as a corporation described in section 3.01 of this announcement.

.04 For transactions occurring in 2002, provided the requirements of this section are satisfied, the corporation is not required to file Form 1099–CAP with the Service with respect to its shareholders, or Form 1096 transmitting Form 1099–CAP. In addition, the corporation is not required to furnish Form 1099–CAP to any of its shareholders.

SECTION 4. TRANSITION RULES FOR BROKERS FOR TRANSACTIONS OCCURRING IN 2002

.01 A broker that holds shares in a corporation that the broker reasonably believes, based on readily available information (including, for example, information from a clearing organization), has engaged in a transaction described in section 3.01 of this announcement must provide a letter to each actual owner of such shares that is not an exempt recipient (as defined in section 1.6043–4T(b)(6)) containing the language set forth in section 3.01 of this announcement. A broker that furnishes this letter to the actual owner satisfies the reporting requirements of section 1.6045–3T. The legend "Important Tax Return Document Enclosed" must appear in a bold and conspicuous manner on the outside of the envelope containing the letter. The letter must be furnished to the actual owner on or before March 15, 2003.

.02 The broker must satisfy any other reporting obligations the broker may have with respect to the transaction. For example, the broker may be required under section 1.6045–1 of the regulations to report cash proceeds from the transaction on Form 1099–B.

.03 The broker is not required to send a letter under section 4.01 of this announcement to the actual owner if the broker furnishes Form 1099–B to the actual owner showing the amount of any cash and the fair market value as of the date of the transaction of the new shares and of any other property received by the actual owner in the transaction.

.04 For transactions occurring in 2002, provided the requirements of this section are satisfied, the broker is not required to file Form 1099–CAP with the Service with respect to the actual owners, or Form 1096 transmitting Form 1099–CAP. In addition, the broker is not required to furnish Form 1099–CAP to the actual owners of such shares.

SECTION 5. DRAFTING INFORMATION

For further information regarding this announcement, contact Nancy Rose of the Office of the Associate Chief Counsel (Procedure & Administration), Administrative Provisions and Judicial Practice Division, at (202) 622–4910 (not toll-free call).

Agent for Consolidated Group; Correction

Announcement 2003–8

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 9002, 2002–29 I.R.B. 120 [67 FR 43538]) that were published in the **Federal Register** on Friday, June 28, 2002, regarding the agent for subsidiaries of an affiliated group that files a consolidated return.

DATES: This correction is effective June 28, 2002.

FOR FURTHER INFORMATION CONTACT: Gerald B. Fleming, (202) 622–7770, or George R. Johnson, (202) 622–7930 (not a toll-free number).

SUPPLEMENTARY INFROMATION:

Background

The final regulations that are the subject of these corrections are under sections 1502 and 6402(j) of the Internal Revenue Code.

Need for Correction

As published, the final regulations contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (T.D. 9002), that were the subject of FR Doc. 02–16399, is corrected as follows:

§ 1.1502–77T [Corrected]

1. On page 43544, column 3, § 1.1502–77T [Removed], line 7, the language "year (or agent designated under" is corrected to read "year (or substitute agent designated under".

§ 602.101 [Corrected]

2. On page 43545, column 1, the amendatory language for paragraph 12 and § 602.101(b) is corrected to read as follows:

12. Section 602.101(b) is amended by removing the entries "1.1502–77..... 1545–0123" and "1.1502–77T..... 1545–1046" and adding new entries for §§ 1.1502–77 and 1.1502–77A in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(b)* * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.1502–77	1545–1699
1.1502–77A	1545–0123 1545–1046
* * * * *	

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

(Filed by the Office of the Federal Register on December 18, 2002, 8:45 a.m., and published in the issue of the Federal Register for December 19, 2002, 67 F.R. 77678)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[2] A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.