Internal Revenue
bulletin

Bulletin No. 1998–46
November 16, 1998

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 98–54, page 14.

LIFO; price indexes; department stores. The September 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1998.

T.D. 8787, page 5.

Final and temporary regulations provide ordering rules for the reduction of basis of property under sections 108 and 1017 of the Code.

EMPLOYEE PLANS

Rev. Rul. 98–53, page 12.

Covered compensation tables; 1999. The covered compensation tables for the 1999 calendar year for determining contributions to defined benefit plans and permitted disparity are set forth.

Notice 98–52, page 16.

Nondiscriminatory safe harbors; ADP test; ACP test. This notice provides guidance on the safe harbor methods contained in sections 401(k)(12) and 401(m)(11) of the Code for satisfying the nondiscrimination tests contained in sections 401(k) and 401(m) for plan years beginning after December 31, 1998.

Notice 98–53, page 24.

Retirement plans; 1999 section 415(d) limitations. Cost-of-living adjustments effective January 1, 1999, applicable to the dollar limits on benefits under qualified defined benefit pension plans and to other provisions affecting (1) certain plans of deferred compensation and (2) "control employees" are set forth.

ADMINISTRATIVE

Notice 98–54, page 25.

Information reporting; qualified student loan interest. Taxpayers are informed that the Service and Treasury are extending the application of Notice 98–7, 1998–3 I.R.B. 54, to information reporting required under section 6050S of the Code for 1999. Further, no reporting is required with respect to "mixed use" loans.

Notice 98–55, page 26.

Qualified offer rule. Public comment is requested on several issues raised by the recently enacted qualified offer rule regarding the award of reasonable administrative and litigation costs to a taxpayer in connection with an administrative or court proceeding.

Rev. Proc. 98–55, page 27.

Late election relief for S corporations. If an S election or other related election is filed after the due date for the desired effective date of that election, special procedures permit taxpayers meeting the eligibility requirements outlined in this revenue procedure to request relief through the service center instead of applying for a private letter ruling. This revenue procedure extends the special procedure for late S corporation elections described in Rev. Proc. 97–40 from 6 months to 12 months (but in no event to later than the unextended due date of the tax return for the first year the corporation intended to be an S corporation), provides similar relief for certain QSub elections, and extends the application of Rev. Proc. 94–23 to ESBT elections. Rev. Procs. 94–23 and 97–40 amplified and superseded.

Rev. Proc. 98–56, page 33.

Section 1374 no-rule. This procedure amplifies the "No Rule" revenue procedure, Rev. Proc. 98–3, 1998–1 I.R.B.

(Continued on page 4)

Finding Lists begin on page 44.

Department of the Treasury
Internal Revenue Service

The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

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 of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1986.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

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.

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ADMINISTRATIVE—Continued

100, to include certain issues arising in the timber, coal, and domestic iron ore industries under sections 631 and 1374 of the Code.

Announcement 98–99, page 34.

Test of mediation procedure for appeals. Appeals is conducting an additional two-year test of its mediation procedure. This announcement contains the procedures that taxpayers may use to request mediation for certain issues that are in the Appeals administrative process and that are not docketed in any court.

Announcement 98–100, page 42.

The Service announces that in order to fully consider comments received in response to draft training materials on the application of section 119 of the Code to the hospitality industry, it will not release final training materials by October 31, 1998. The Service confirms that taxpayers will have until 30 days after the final materials are issued to indicate interest in accepting the related settlement initiative, and the Service responds to a question about the terms of the settlement initiative.

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

Section 108.—Income From Discharge of Indebtedness

26 CFR 1.108–4: Election to reduce basis of depreciable property under section 108(b)(5) of the Internal Revenue Code.

T.D. 8787

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

Basis Reduction Due to Discharge of Indebtedness

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final and temporary regulations that provide ordering rules for the reduction of bases of property under sections 108 and 1017 of the Internal Revenue Code of 1986. The regulations will affect taxpayers that exclude discharge of indebtedness income from gross income under section 108.

DATES: *Effective Date:* These regulations are effective, October 22, 1998.

Applicability Date: These regulations apply to discharges of indebtedness occurring on or after, October 22, 1998 and to elections under section 108(b)(5) concerning discharges of indebtedness occurring on or after, October 22, 1998.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations generally, Sharon L. Hall or Christopher F. Kane of the Office of Assistant Chief Counsel (Income Tax & Accounting) at (202) 622-4930; concerning partnership adjustments under section 1017, Matthew Lay of the Office of Assistant Chief Counsel (Passthroughs & Special Industries) at (202) 622-3050.

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this final regulation have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545–1539. Responses to these collections of information are required to obtain a benefit.

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

The estimated annual burden per respondent is 1 hour.

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

Books or records relating to 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 final regulation contains amendments to the income tax regulations (26 CFR Parts 1 and 301) under sections 108 and 1017 of the Internal Revenue Code of 1986 (Code). The amendments conform the regulations to amendments to sections 108 and 1017 made by the Bankruptcy Tax Act of 1980, Public Law 96–589, §§2, 94 (Stat. 3389 (1980)); 1980–2 C.B. 607 (Bankruptcy Tax Act); the Technical Corrections Act of 1982, Public Law 97–448, §102(h)(1), 96 (Stat. 2365, 2372 (1983)); 1983–1 C.B. 451; the Deficit Reduction Act of 1984, Public Law 98–369, sections 474(r)(5) and 721(b)(2), 98 (Stat. 494, 839, 966 (1984)); 1984–3 C.B. (Vol. 1) 1; the Tax Reform Act of 1986, Public Law 99–514, sections 104(b)(2), 231(d)(3)(D), 822, and 1171(b)(4), 100 (Stat. 2085, 2105, 2179, 2373, 2513 (1986)); 1986–3 C.B. (Vol. 1) 2; and the Omnibus Budget Reconciliation Act of 1993, Public Law 103–66, section 13150, 107 (Stat. 312, 446 (1993)); 1993–3 C.B. 1.

On January 7, 1997, proposed regulations (REG–208172–91), were published in the **Federal Register** (62 F.R. 955). Written comments were received in response to the notice of proposed rulemaking. One speaker provided testimony at a public hearing held on May 29, 1997.

After consideration of all the comments, the proposed regulations under sections 108 and 1017 are adopted, as revised by this Treasury decision.

Explanation of Revisions and Summary of Comments

1. *Basis Reduction Limited to Fair Market Value*

One commentator requested that basis reduction be limited to fair market value as provided by §1.1016–7(a) (as removed by this regulation). The final regulations do not adopt this recommendation. Section 1017, as enacted by the Bankruptcy Tax Act, fundamentally changed the rules relating to basis reduction where discharge of indebtedness income (cancellation of debt (COD) income) is excluded from gross income. The revised statute, in section 1017(b)(2), provides only one limitation on basis reduction for insolvent and bankrupt taxpayers who do not make an election under section 108(b)(5). Under that rule, the basis reduction may not exceed the excess of the aggregate of the bases of the property held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge. The fair market value limitation found in the regulations removed by this Treasury decision is not reflected in section 1017. Accordingly, the IRS and Treasury Department do not believe that a rule limiting basis reduction to fair market value would be appropriate.

2. *Section 108(c)(2)(A) Limitation*

Section 1.108–5(a) of the proposed regulations described the limitation under section 108(c)(2)(A) and provided that the amount excluded under section 108(a)(1)(D) (concerning discharges of qualified real property business indebtedness) could not exceed the excess of the outstanding principal amount of that indebtedness immediately before the discharge over the net fair market value of the qualifying real property (as defined under §1.1017–1(c)(1)) immediately before the discharge. Two commentators requested that the regulations clarify that any outstanding accrued and unpaid interest is included in determining the outstanding principal amount of the indebtedness for purposes of this limitation. Given the purpose of this limitation, which is to prevent taxpayers from using the section 108(a)(1)(D) exclusion to the extent that debt cancellation would create equity in property (H.R. Rep. 103–111, 103d Cong., 1st Sess., 622–23 (1993)), the IRS and Treasury Department believe that it is inappropriate to strictly limit the exclusion by reference to the amount stated as principal in the debt instrument. Accordingly, the final regulations provide that, for purposes of section 108(c)(2)(A) and §1.108–6 only, outstanding principal amount means the principal amount of an indebtedness and all additional amounts owed that, immediately before the discharge, are equivalent to principal, in that interest on such amounts would accrue and compound in the future. Amounts that are subject to section 108(e)(2) are excepted from the definition of principal amount. In addition, principal amount must be adjusted to account for unamortized premium and discount consistent with section 108(e)(3).

3. *Allocation of Basis Reduction of Multiple Properties Within the Same Class*

The proposed regulations incorporated the limitation described in section 1017(b)(2) which provides that the basis reduction for bankrupt and insolvent taxpayers may not exceed the excess of the aggregate of the bases of the property held by the taxpayer immediately after the discharge over the aggregate of the liabilities of the taxpayer immediately after the discharge. A commentator suggested that this limitation be applied on a class by class basis, so that when a basis reduction applied within a single class of properties described in §1.1017–1(a) exceeds the amount of basis over the debt secured by the properties in that class, the basis reduction in excess of that amount should default to the next class.

The final regulations do not adopt this comment.

The overall limitation on basis reduction is determined by reference to the adjusted basis of property and the amount of money held by the taxpayer over the liabilities of the taxpayer "immediately after the discharge." By contrast, under the basis reduction rules applicable for purposes of section 108(b)(2)(E), the taxpayer must reduce the adjusted basis of property "held by the taxpayer at the beginning of the taxable year following the year in which the discharge occurs." Section 1017(a). Given the difference in the relevant time for applying the basis limitation and the basis reduction rules, and the relative complexity of the calculations necessary to implement the proposal, the IRS and Treasury Department believe that the suggested limitation is not workable. Accordingly, the final regulations continue to apply the limitation based on the aggregate bases and liabilities of the taxpayer consistent with section 1017(b)(2).

The proposed regulations also provided that a taxpayer must treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's interest in that partnership. The rule in the proposed regulations for allocating basis reduction among multiple properties under section 108(b)(2)(E) contained parenthetical language cross-referencing the partnership provision for the property classes that included secured real and personal property used in a trade or business or held for investment. This parenthetical language was intended to remind taxpayers that partnership indebtedness is treated as indebtedness secured by the taxpayer's interest in the partnership.

One commentator stated that the cross-reference with respect to secured real property was confusing since a partnership interest presumably should be treated as personal property in reducing basis under section 108(b)(2)(E). This is contrasted with the modified basis reduction rules under sections 108(b)(5) and 108(c) which, assuming the appropriate requests are made and consents are granted, apply a look-through rule to reduce the inside basis of depreciable property or depreciable real property held by a partnership.

In order to eliminate this confusion, the parenthetical language is not included in the final regulations. However, as under the proposed regulations, the final regulations continue to treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's partnership interest. Accordingly, the elimination of the parenthetical language is not intended to change the substantive results obtained in allocating a basis reduction among multiple properties.

4. *Meaning of "In Connection With" In Section 108(c)(3)*

A commentator requested that the final regulations provide that the phrase "in connection with" in section 108(c)(3) does not require that the proceeds of debt incurred or assumed before January 1, 1993 be traced to real property used in a trade or business, but only requires that the debt be secured by real property used in a trade or business as of January 1, 1993. The final regulations do not adopt this comment. Section 108(c)(3)(A) defines *qualified real property business indebtedness* as indebtedness which "was incurred or assumed by the taxpayer in-connection with real property used in a trade or business and is secured by such real property". The IRS and Treasury Department do not believe that this sentence should be interpreted to mean only that the debt must be secured by real property used in a trade or business as of January 1, 1993.

5. *Basis Reduction With Respect to a Residence*

A commentator requested that when the basis of a taxpayer's residence is reduced under section 1017 and is disposed of in a transaction subject to section 1034 (which provided for the deferral of gain on the sale of a personal residence), the potential recapture income arising under section 1245 should be carried into the replacement property. This comment is not adopted in the final regulations. Section 1034 was repealed by the Taxpayer Relief Act of 1997. New section 121, enacted by the Taxpayer Relief Act of 1997, exempts certain gain on the sale of a residence, but does not provide that the potential gain will be transferred to a replacement residence. Therefore, under the new law, there is no mechanism to preserve the potential recapture income with respect to a new residence, and the potential recapture income must be recognized on the sale of the residence under section 1245.

6. *Mandatory Request and Consent*

The proposed regulations provided that a partner may treat a partnership interest as depreciable property under section 108(b)(5) (or as depreciable real property under section 108(c)) only if the partnership consents to make corresponding adjustments to the basis of the partnership's depreciable property (or depreciable real property). The IRS and Treasury Department generally believe, in this context, that whether or not a partnership consents to make the corresponding adjustments to the basis of its property should be a matter of agreement between the partner and the partnership. Therefore, the proposed regulations generally provided that a partner is free to choose whether or not to request that a partnership reduce the basis of partnership property and that the partnership is free to grant or withhold its consent.

The ability to freely choose whether or not to request or grant consent, however, provides opportunities to avoid the general ordering rules of the proposed regulations through the use of a partnership. Therefore, the proposed regulations provided that, in a limited number of situations; (i) a partner is required to request the partnership's consent, and (ii) the partnership is required to grant that consent. Specifically, the proposed regulations provided that a partner is required to request consent if the partner owns (directly or indirectly) more than 50 percent of the capital and profits interests of the partnership, or if the partner receives a distributive share of COD income from the partnership. In addition, the partnership is required to grant consent if requests are made by partners owning (directly or indirectly) an aggregate of more than 50 percent of the capital and profits interests of the partnership.

One commentator requested revisions to the mandatory request and consent rules contained in the proposed regulations. This commentator argued that the proposed regulations, as written, could unduly burden certain large partnerships in situations where the partnership's refusal to consent was not motivated by tax avoidance. The commentator requested that the mandatory consent rule be revised to require a partnership to consent only if the partnership receives requests from five or fewer partners who own, in the aggregate, more than 50 percent of the capital and profits of the partnership.

To ensure that partnerships are not unduly burdened by the mandatory request and consent rules, the commentator's proposal has been adopted, in part, in the final regulations. However, to preserve the general ordering rules of the regulations, the IRS and Treasury Department believe that it is appropriate to require a partnership to consent to reduce the basis of its depreciable property (or depreciable real property) where a substantial majority of its partners elect to exclude the COD income under sections 108(b)(5) or 108(c). Therefore, the final regulations provide that a partnership must consent to reduce its partners' shares of the partnership's depreciable basis in depreciable property (or depreciable real property) if consent is requested by; (i) partners owning (directly or indirectly) an aggregate of more than 80 percent of the capital and profits interests of the partnership, or (ii) five or fewer partners owning (directly or indirectly) an aggregate of more than 50 percent of the capital and profits interests of the partnership.

As in the proposed regulations, the final regulations do not require a partnership to reduce the basis of its depreciable property (or depreciable real property) in all situations where the partnership is the source of the COD income. However, where a partnership is the source of the COD income and partners elect to exclude such income, such partners are required to request that the partnership reduce its basis in such property. Accordingly, if partners meeting the requirements in (i) or (ii) above elect to exclude such income, the partnership must consent to reduce the basis of its depreciable property (or depreciable real property).

Commentators also requested that the final regulations clarify that a partnership's consent is not required for basis adjustments under section 108(b)(2)(E). The final regulations make it clear that a partnership's consent to reduce the basis of the partnership's depreciable property (or depreciable real property) is neither required nor relevant where a partner reduces the basis in its partnership interest under section 108(b)(2)(E).

7. *Treatment of the Adjustment to the Basis of Partnership Property Under Subchapter K*

One commentator requested that the final regulations address a number of issues concerning the treatment of the partnership's adjustments to the basis of partnership property under subchapter K. The final regulations do not address these issues. Instead, the IRS and Treasury Department have addressed these issues in the proposed regulations recently promulgated under sections 743 and 755.

8. *Timing and Reporting*

The proposed regulations provided that a partner requesting a reduction in inside basis must make the request and receive consent before the due date (including extensions) for filing the partner's Federal income tax return for the taxable year in which the partner has COD income. The proposed regulations also provided that a partnership that consents to a basis reduction must include a consent statement with its Form 1065, U.S. Partnership Return of Income, and provide a copy of that statement to the affected partner on or before the date the Form 1065 is filed. One commentator stated that the final regulations should provide that; (i) partners should not be required to request consent, and (ii) neither the partner nor the partnership should be required to attach statements to their returns, until the filing date of their respective returns for the taxable year following the year that the partner excludes COD income.

The IRS and Treasury Department continue to believe that a partner electing under sections 108(b)(5) or 108(c) must receive the consent of the partnership before the partner excludes the COD income. Therefore, the final regulations provide that the partner must request and receive the consent of the partnership prior to the due date (including extensions) for filing the partner's Federal income tax return for the taxable year in which the partner has COD income. The final regulations do, however, adopt the commentator's suggestion that the partnership is not required to attach a statement to its return until the filing date of its

Federal income tax return for the taxable year following the year that ends with or within the taxable year that the partner excludes the COD income.

The commentator also stated that the final regulations should provide that when a partnership recognizes any COD income from qualified real property business indebtedness it should attach a statement to its partners' Forms K–1 stating that the COD income is from qualified real property business indebtedness and the date the cancellation occurred. The final regulations do not adopt this proposal. The IRS and Treasury Department believe that §1.703–1(a)(1) currently requires partnerships to separately state qualified real property business indebtedness and identify it as such.

The IRS and Treasury Department recognize that a partner might not always have sufficient information with which to decide to request a basis reduction until on, or shortly before, the due date (including extensions) for filing the partner's Federal income tax return. Therefore, comments were requested as to whether additional rules (such as requiring a partnership to inform partners of COD income prior to the date the Form 1065 is filed) are necessary to ensure that information is exchanged between the partnership and its partners in a timely fashion. The final regulations do not require partnerships to inform their partners of COD income prior to the date the Form 1065 is filed. Instead, the IRS and Treasury Department believe that any additional administrative burdens imposed on partnerships should be the result of an understanding between the partners and the partnership.

9. *Methods Used Prior to Issuance of Final Regulations*

A commentator requested that, for cancellation of debt events occurring prior to the issuance of final regulations, taxpayers be allowed to use any reasonable method that conforms with existing regulations or the proposed regulations in determining which properties are subject to the basis adjustments under sections 108 and 1017. This suggestion to provide for retroactive application of these regulations has not been adopted.

Special Analyses

It has been determined that this final regulation is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has been determined that a final regulatory flexibility analysis is required for the collection of information in this Treasury decision under 5 U.S.C. 604. A summary of the analysis is set forth below under the heading "Summary of Final Regulatory Flexibility Act Analysis." Pursuant to section 7805(f) of the Internal Revenue Code, this final regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Summary of Final Regulatory Flexibility Act Analysis

This analysis is required under the Regulatory Flexibility Act (5 U.S.C. chapter 6). In certain circumstances, the final regulations will require a partnership to include a statement with its Form 1065, U.S. Partnership Return of Income, for the taxable year following the year that ends with or within the taxable year the taxpayer excludes COD income from gross income, and provide a statement to the taxpayer on or before the due date of the requesting partner's return (including extensions) for the taxable year in which the COD income is excluded under section 108(a), stating the amount of the partner's share of the reduction in the partnership's adjusted bases of depreciable real or personal property (inside basis). This requirement will ensure that the partner knows it is entitled to reduce the adjusted basis of the partnership interest and that the affected partnership knows it must reduce the partner's interest in inside basis. The legal basis for this requirement is contained in sections 1017(b), 6001, and 7805(a).

Though the final regulations might affect any partnership owning depreciable property, the IRS and Treasury Department believe that partnerships owning depreciable real property are the most likely to be affected. Approximately 1,560,000 partnership returns were filed for 1993. Approximately 620,000 of these were for partnerships owning real property. It is unlikely, however, that many of these partnerships or partners in these partnerships will have COD income in any given year, so it is anticipated that only a small number of these partnerships will be affected by the final regulations in a particular year.

After a partner conveys information concerning the amount of COD income excluded from gross income under section 108(a) to the affected partnership, the partnership must reduce the partner's interest in inside basis. Accordingly, the partnership must prepare and maintain special entries on its books because this basis reduction will reduce the partner's share of the partnership's depreciation deductions, and ultimate gain or loss on the sale of the property, in subsequent years. In many cases, partnership returns are prepared using computer software that can prepare and maintain these special entries after the initial year.

The IRS and Treasury Department are not aware of any federal rules that may duplicate, overlap, or conflict with the rule in the final regulation.

As an alternative to the disclosure described above, the IRS and Treasury Department considered, but rejected as too burdensome, a rule that would have required an affected partnership to disclose the reductions of adjusted basis on a property-by-property basis. There are no known alternative rules that are less burdensome to small entities but that accomplish the purpose of the statute.

Drafting Information

The principal authors of these regulations are Sharon L. Hall, Office of Assistant Chief Counsel (Income Tax and Accounting) and Brian Blum, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.108–4 also issued under 26 U.S.C. 108.

Section 1.108–5 also issued under 26 U.S.C. 108. * * *

Section 1.1017–1 also issued under 26 U.S.C. 1017. * * *

Par. 2. Section 1.108-4 is added to read as follows:

§1.108–4 Election to reduce basis of depreciable property under section 108(b)(5) of the Internal Revenue Code .

(a) *Description.* An election under section 108(b)(5) is available whenever a taxpayer excludes discharge of indebtedness income (COD income) from gross income under sections 108(a)(1)(A), (B), or (C) (concerning title 11 cases, insolvency, and qualified farm indebtedness, respectively). See sections 108(d)(2) and (3) for the definitions of *title 11 case* and *insolvent.* See section 108(g)(2) for the definition of *qualified farm indebtedness.*

(b) *Time and manner.* To make an election under section 108(b)(5), a taxpayer must enter the appropriate information on Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment),* and attach the form to the timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a). An election under this section may be revoked only with the consent of the Commissioner.

(c) *Effective date.* This section applies to elections concerning discharges of indebtedness occurring on or after October 22, 1998.

§1.108(c)–1 [Redesignated as §1.108–5]

Par. 3. Section 1.108(c)–1 is redesignated as §1.108–5.

Par. 4. Section 1.108–6 is added to read as follows:

§1.108–6 Limitations on the exclusion of income from the discharge of qualified real property business indebtedness.

(a) *Indebtedness in excess of value.* With respect to any qualified real property business indebtedness that is discharged, the amount excluded from gross income under section 108(a)(1)(D) (concerning discharges of qualified real property business indebtedness) shall not exceed the excess, if any, of the outstanding principal amount of that indebtedness immediately before the discharge over the net fair market value of the qualifying real property, as defined in §1.1017–1(c)(1), immediately before the discharge. For purposes of this section, *net fair market value* means the fair market value of the qualifying real property (notwithstanding section 7701(g)), reduced by the outstanding principal amount of any qualified real property business indebtedness (other than the discharged indebtedness) that is secured by such property immediately before and after the discharge. Also, for purposes of section 108(c)(2)(A) and this section, outstanding principal amount means the principal amount of indebtedness together with all additional amounts owed that, immediately before the discharge, are equivalent to principal, in that interest on such amounts would accrue and compound in the future, except that outstanding principal amount shall not include amounts that are subject to section 108(e)(2) and shall be adjusted to account for unamortized premium and discount consistent with section 108(e)(3).

(b) *Overall limitation.* The amount excluded from gross income under section 108(a)(1)(D) shall not exceed the aggregate adjusted bases of all depreciable real property held by the taxpayer immediately before the discharge (other than depreciable real property acquired in contemplation of the discharge) reduced by the sum of any—

(1) Depreciation claimed for the taxable year the taxpayer excluded discharge of indebtedness from gross income under section 108(a)(1)(D); and

(2) Reductions to the adjusted bases of depreciable real property required under section 108(b) or section 108(g) for the same taxable year.

(c) *Effective date.* This section applies to discharges of qualified real property business indebtedness occurring on or after, October 22, 1998.

§1.108(a)–1 [Removed]

Par. 5. Section 1.108(a)–1 is removed.

§1.108(a)–2 [Removed]

Par. 6. Section 108(a)–2 is removed.

§1.108(b)–1 [Removed]

Par. 7. Section 1.108–(b)-1 is removed.

§1.1016–7 [Removed]

Par. 8. Section 1.1016–7 is removed.

§1.1016–8 [Removed]

Par. 9. Section 1.1016–8 is removed.

Par. 10. Section 1.1017–1 is revised to read as follows:

§1.1017–1 Basis reductions following a discharge of indebtedness.

(a) *General rule for section 108(b)-(2)(E).* This paragraph (a) applies to basis reductions under section 108(b)(2)(E) that are required by section 108(a)(1)(A) or (B) because the taxpayer excluded discharge of indebtedness (COD income) from gross income. A taxpayer must reduce in the following order, to the extent of the excluded COD income (but not below zero), the adjusted bases of property held on the first day of the taxable year following the taxable year that the taxpayer excluded COD income from gross income (in proportion to adjusted basis)—

(1) Real property used in a trade or business or held for investment, other than real property described in section 1221(1), that secured the discharged indebtedness immediately before the discharge;

(2) Personal property used in a trade or business or held for investment, other than inventory, accounts receivable, and notes receivable, that secured the discharged indebtedness immediately before the discharge;

(3) Remaining property used in a trade or business or held for investment, other than inventory, accounts receivable, notes receivable, and real property described in section 1221(1);

(4) Inventory, accounts receivable, notes receivable, and real property described in section 1221(1); and

(5) Property not used in a trade or business nor held for investment.

(b) *Operating rules*—(1) *Prior tax-attribute reduction.* The amount of excluded COD income applied to reduce basis does not include any COD income applied to reduce tax attributes under sections 108(b)(2)(A) through (D) and, if applicable, section 108(b)(5). For example, if a taxpayer excludes $100 of COD income from gross income under section 108(a) and reduces tax attributes by $40 under sections 108(b)(2)(A) through (D), the taxpayer is required to reduce the adjusted bases of property by $60 ($100 – $40) under section 108(b)(2)(E).

(2) *Multiple discharged indebtednesses.* If a taxpayer has COD income attributable to more than one discharged indebtedness resulting in the reduction of tax attributes under sections 108(b)(2)(A) through (D) and, if applicable, section 108(b)(5), paragraph (b)(1) of this section must be applied by allocating the tax-attribute reductions among the indebtednesses in proportion to the amount of COD income attributable to each discharged indebtedness. For example, if a taxpayer excludes $20 of COD income attributable to secured indebtedness A and excludes $80 of COD income attributable to unsecured indebtedness B (a total exclusion of $100), and if the taxpayer reduces tax attributes by $40 under sections 108(b)(2)(A) through (D), the taxpayer must reduce the amount of COD income attributable to secured indebtedness A to $12 ($20 – ($20 / $100 × $40)) and must reduce the amount of COD income attributable to unsecured indebtedness B to $48 ($80 – ($80 / $100 × $40)).

(3) *Limitation on basis reductions under section 108(b)(2)(E) in bankruptcy or insolvency.* If COD income arises from a discharge of indebtedness in a title 11 case or while the taxpayer is insolvent, the amount of any basis reduction under section 108(b)(2)(E) shall not exceed the excess of—

(i) The aggregate of the adjusted bases of property and the amount of money held by the taxpayer immediately after the discharge; over

(ii) The aggregate of the liabilities of the taxpayer immediately after the discharge.

(c) *Modification of ordering rules for basis reductions under sections 108(b)(5) and 108(c)*—(1) *In general.* The ordering rules prescribed in paragraph (a) of this section apply, with appropriate modifications, to basis reductions under sections 108(b)(5) and (c). Thus, a taxpayer that elects to reduce basis under section 108(b)(5) may, to the extent that the election applies, reduce only the adjusted basis of property described in paragraphs (a)(1), (2), and (3) of this section and, if an election is made under paragraph (f) of this section, paragraph (a)(4) of this section. Within paragraphs (a)(1),(2), (3) and (4) of this section, such a taxpayer may reduce only the adjusted bases of depreciable property. A taxpayer that elects to apply section 108(c) may reduce only the adjusted basis of property described in paragraphs (a)(1) and (3) of this section and, within paragraphs (a)(1) and (3) of this section, may reduce only the adjusted bases of depreciable real property. Furthermore, for basis reductions under section 108(c), a taxpayer must reduce the adjusted basis of the qualifying real property to the extent of the discharged qualified real property business indebtedness before reducing the adjusted bases of other depreciable real property. The term *qualifying real property* means real property with respect to which the indebtedness is qualified real property business indebtedness within the meaning of section 108(c)(3). See paragraphs (f) and (g) of this section for elections relating to section 1221(1) property and partnership interests.

(2) *Partial basis reductions under section 108(b)(5).* If the amount of basis reductions under section 108(b)(5) is less than the amount of the COD income excluded from gross income under section 108(a), the taxpayer must reduce the balance of its tax attributes, including any remaining adjusted bases of depreciable and other property, by following the ordering rules under section 108(b)(2). For example, if a taxpayer excludes $100 of COD income from gross income under section 108(a) and elects to reduce the adjusted bases of depreciable property by $10 under section 108(b)(5), the taxpayer must reduce its remaining tax attributes by $90, starting with net operating losses under section 108(b)(2).

(3) *Modification of fresh start rule for prior basis reductions under section 108(b)(5).* After reducing the adjusted bases of depreciable property under section 108(b)(5), a taxpayer must compute the limitation on basis reductions under section 1017(b)(2) using the aggregate of the remaining adjusted bases of property. For example, if, immediately after the discharge of indebtedness in a title 11 case, a taxpayer's adjusted bases of property is $100 and its undischarged indebtedness is $70, and if the taxpayer elects to reduce the adjusted bases of depreciable property by $10 under section 108(b)(5), section 1017(b)(2) limits any further basis reductions under section 108(b)(2)(E) to $20 (($100 – $10) – $70).

(d) *Changes in security.* If any property is added or eliminated as security for an indebtedness during the one-year period preceding the discharge of that indebtedness, such addition or elimination shall be disregarded where a principal purpose of the change is to affect the taxpayer's basis reductions under section 1017.

(e) *Depreciable property.* For purposes of this section, the term *depreciable property* means any property of a character subject to the allowance for depreciation or amortization, but only if the basis reduction would reduce the amount of depreciation or amortization which otherwise would be allowable for the period immediately following such reduction. Thus, for example, a lessor cannot reduce the basis of leased property where the lessee's obligation in respect of the property will restore to the lessor the loss due to depreciation during the term of the lease, since the lessor cannot take depreciation in respect of such property.

(f) *Election to treat section 1221(1) real property as depreciable*—(1) *In general.* For basis reductions under section 108(b)(5) and basis reductions relating to qualified farm indebtedness, a taxpayer may elect under sections 1017(b)(3)(E) and (4)(C), respectively, to treat real property described in section 1221(1) as depreciable property. This election is not available, however, for basis reductions under section 108(c).

(2) *Time and manner.* To make an election under section 1017(b)(3)(E) or (4)(C), a taxpayer must enter the appropriate information on Form 982, *Reduction of Tax Attributes Due to Discharge of Indebtedness (and Section 1082 Basis Adjustment)*, and attach the form to a timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a). An election under this paragraph (f) may be revoked only with the consent of the Commissioner.

(g) *Partnerships*—(1) *Partnership COD income.* For purposes of paragraph

(a) of this section, a taxpayer must treat a distributive share of a partnership's COD income as attributable to a discharged indebtedness secured by the taxpayer's interest in that partnership.

(2) *Partnership interest treated as depreciable property*—(i) *In general.* For purposes of making basis reductions, if a taxpayer makes an election under section 108(b)(5) (or 108(c)), the taxpayer must treat a partnership interest as depreciable property (or depreciable real property) to the extent of the partner's proportionate share of the partnership's basis in depreciable property (or depreciable real property), provided that the partnership consents to a corresponding reduction in the partnership's basis (inside basis) in depreciable property (or depreciable real property) with respect to such partner.

(ii) *Request by partner and consent of partnership*—(A) *In general.* Except as otherwise provided in this paragraph (g)(2)(ii), a taxpayer may choose whether or not to request that a partnership reduce the inside basis of its depreciable property (or depreciable real property) with respect to the taxpayer, and the partnership may grant or withhold such consent, in its sole discretion. A request by the taxpayer must be made before the due date (including extensions) for filing the taxpayer's Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a).

(B) *Request for consent required.* A taxpayer must request a partnership's consent to reduce inside basis if, at the time of the discharge, the taxpayer owns (directly or indirectly) a greater than 50 percent interest in the capital and profits of the partnership, or if reductions to the basis of the taxpayer's depreciable property (or depreciable real property) are being made with respect to the taxpayer's distributive share of COD income of the partnership.

(C) *Granting of request required.* A partnership must consent to reduce its partners' shares of inside basis with respect to a discharged indebtedness if consent is requested with respect to that indebtedness by partners owning (directly or indirectly) an aggregate of more than 80 percent of the capital and profits interests of the partnership or five or fewer partners owning (directly or indirectly) an aggregate of more than 50 percent of the capital and profits interests of the partnership. For example, if there is a cancellation of partnership indebtedness that is secured by real property used in a partnership's trade or business, and if partners owning (in the aggregate) 90 percent of the capital and profits interests of the partnership elect to exclude the COD income under section 108(c), the partnership must make the appropriate reductions in those partners' shares of inside basis.

(iii) *Partnership consent statement*—(A) *Partnership requirement.* A consenting partnership must include with the Form 1065, U.S. Partnership Return of Income, for the taxable year following the year that ends with or within the taxable year the taxpayer excludes COD income from gross income under section 108(a), and must provide to the taxpayer on or before the due date of the taxpayer's return (including extensions) for the taxable year in which the taxpayer excludes COD income from gross income, a statement that—

(*1*) Contains the name, address, and taxpayer identification number of the partnership; and

(*2*) States the amount of the reduction of the partner's proportionate interest in the adjusted bases of the partnership's depreciable property or depreciable real property, whichever is applicable.

(B) *Taxpayer's requirement.* Statements described in paragraph (g)(2)(iii)(A) of this section must be attached to a taxpayer's timely filed (including extensions) Federal income tax return for the taxable year in which the taxpayer has COD income that is excluded from gross income under section 108(a).

(iv) *Partner's share of partnership's adjusted basis.* [Reserved]

(3) *Partnership basis reduction.* The rules of this section (including this paragraph (g)) apply in determining the properties to which the partnership's basis reductions must be made.

(h) *Special allocation rule for cases to which section 1398 applies.* If a bankruptcy estate and a taxpayer to whom section 1398 applies (concerning only individuals under Chapter 7 or 11 of title 11 of the United States Code) hold property subject to basis reduction under section 108(b)(2)(E) or (5) on the first day of the taxable year following the taxable year of discharge, the bankruptcy estate must reduce all of the adjusted bases of its property before the taxpayer is required to reduce any adjusted bases of property.

(i) *Effective date.* This section applies to discharges of indebtedness occurring on or after October 22, 1998.

§1.1017–2 [Removed]

Par. 11. Section 1.1017–2 is removed.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 12. The authority citation for part 301 continues to read as follows:

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

§301.9100–13T [Removed]

Par. 13. Section 301.9100–13T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 15. Section 602.101(c) is amended by:

1. Adding the following entries in numerical order to the table:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.108–4	1545–1539
1.108–5	1545–1421
* * * * *	
1.1017–1	1 545–1539
* * * * *	

2. Removing the following entries in numerical order from the table:

* * * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.108(a)–1	1545–0046
1.108(a)–2	1545–0046
1.108(c)–1	1545–1421
* * * * *	
1.1017–2	1545–0028
	1545–0046
* * * * *	
301.9100–13T	1545–0046

Michael P. Dolan,
Commissioner of Internal Revenue.

Approved September 14, 1998.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 21, 1998, at 8:45 a.m., and published in the issue of the Federal Register for October 22, 1998, 63 F.R. 56559)

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(l)–1: Permitted disparity with respect to employer-provided contributions or benefits.

Covered compensation tables; 1999. The covered compensation tables for the 1999 calendar year for determining contributions to defined benefit plans and permitted disparity are set forth.

Rev. Rul. 98–53

This revenue ruling provides tables of covered compensation under § 401(l)-(5)(E) of the Internal Revenue Code (the "Code") and the Income Tax Regulations, thereunder, for the 1999 plan year.

Section 401(l)(5)(E)(i) defines covered compensation with respect to an employee, as the average of the contribution and benefit bases in effect under § 230 of the Social Security Act (the "Act") for each year in the 35-year period ending with the year in which the employee attains social security retirement age.

Section 401(l)(5)(E)(ii) of the Code states that the determination for any year preceding the year in which the employee attains social security retirement age shall be made by assuming that there is no increase in covered compensation after the determination year and before the employee attains social security retirement age.

Section 1.401(l)–1(c)(34) of the regulations defines the taxable wage base as the contribution and benefit base under § 230 of the Act.

Section 1.401(l)–1(c)(7)(i) defines covered compensation for an employee as the average (without indexing) of the taxable wage bases in effect for each calendar year during the 35-year period ending with the last day of the calendar year in which the employee attains (or will attain) social security retirement age. A 35-year period is used for all individuals regardless of the year of birth of the individual. In determining an employee's covered compensation for a plan year, the taxable wage base for all calendar years beginning after the first day of the plan year is assumed to be the same as the taxable wage base in effect as of the beginning of the plan year. An employee's covered compensation for a plan year beginning after the 35-year period applicable under § 1.401(l)–1(c)(7)(i) is the employee's covered compensation for a plan year during which the 35-year period ends. An employee's covered compensation for a plan year beginning before the 35-year period applicable under this § 1.401(l)–1(c)(7)(i) is the taxable wage base in effect as of the beginning of the plan year.

Section 1.401(l)–1(c)(7)(ii) provides that, for purposes of determining the amount of an employee's covered compensation under § 1.401(l)–1(c)(7)(i), a plan may use tables, provided by the Commissioner, that are developed by rounding the actual amounts of covered compensation for different years of birth.

For purposes of determining covered compensation for the 1999 year the taxable wage base is $72,600.

The following tables provide covered compensation for 1999:

1999 Covered Compensation Table

Calendar Year of Birth	Calendar Year of Social Security Retirement Age	1999 Covered Compensation
1907	1972	$4,488
1908	1973	4,704
1909	1974	5,004
1910	1975	5,316
1911	1976	5,664
1912	1977	6,060
1913	1978	6,480
1914	1979	7,044
1915	1980	7,692
1916	1981	8,460
1917	1982	9,300
1918	1983	10,236
1919	1984	11,232

1999 Covered Compensation Table (Continued)

Calendar Year of Birth	Calendar Year of Social Security Retirement Age	1999 Covered Compensation
1920	1985	12,276
1921	1986	13,368
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312
1926	1991	19,728
1927	1992	21,192
1928	1993	22,716
1929	1994	24,312
1930	1995	25,920
1931	1996	27,576
1932	1997	29,304
1933	1998	31,128
1934	1999	33,060
1935	2000	34,992
1936	2001	36,888
1937	2002	38,772
1938	2004	42,468
1939	2005	44,328
1940	2006	46,176
1941	2007	47,988
1942	2008	49,752
1943	2009	51,456
1944	2010	53,124
1945	2011	54,768
1946	2012	56,364
1947	2013	57,936
1948	2014	59,352
1949	2015	60,684
1950	2016	61,920
1951	2017	63,060
1952	2018	64,116
1953	2019	65,112
1954	2020	66,060
1955	2022	67,752
1956	2023	68,544
1957	2024	69,240
1958	2025	69,852
1959	2026	70,404
1960	2027	70,884
1961	2028	71,316
1962	2029	71,664
1963	2030	71,988
1964	2031	72,264
1965	2032	72,480
1966 or later	2033	72,600

1999 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1934	33,000
1935 – 1936	36,000
1937	39,000
1938	42,000
1939 – 1940	45,000
1941	48,000
1942 – 1943	51,000
1944 – 1945	54,000
1946 – 1947	57,000
1948 – 1949	60,000
1950 – 1952	63,000
1953 – 1954	66,000
1955 – 1959	69,000
1960 – 1964	72,000
1965 or later	72,600

Drafting Information

The principal author of this revenue ruling is Todd Newman of the Employee Plans Division. For further information regarding this revenue ruling, call (202) 622-6076 between 2:30 and 3:30 Eastern time (not a toll free number) Monday thru Thursday. Mr. Newman's number is (202) 622-8458 (also not a toll free number).

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

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

LIFO; price indexes; department stores. The September 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, September 30, 1998.

Rev. Rul. 98–54

The following Department Store Inventory Price Indexes for September 1998 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472–1(k) of the Income Tax Regulations and Rev. Proc. 86–46, 1986–2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, September 30, 1998.

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

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

Groups	Sept. 1997	Sept. 1998	Percent Change from Sept.1997 to Sept. 1998[1]
1. Piece Goods	521.1	542.3	4.1
2. Domestics and Draperies	646.6	634.0	–1.9
3. Women's and Children's Shoes	652.0	664.9	2.0
4. Men's Shoes	902.9	915.1	1.4
5. Infants' Wear	623.3	621.4	–0.3
6. Women's Underwear	557.8	569.3	2.1
7. Women's Hosiery	304.3	308.7	1.4
8. Women's and Girls' Accessories	544.1	545.7	0.3
9. Women's Outerwear and Girls' Wear	422.2	419.3	–0.7
10. Men's Clothing	620.2	614.9	–0.9
11. Men's Furnishings	603.1	595.5	–1.3

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

Groups	Sept. 1997	Sept. 1998	Percent Change from Sept.1997 to Sept. 1998[1]
12. Boys' Clothing and Furnishings	498.7	511.6	2.6
13. Jewelry	1009.5	973.7	–3.5
14. Notions	842.0	754.8	–10.4
15. Toilet Articles and Drugs	904.6	939.8	3.9
16. Furniture and Bedding	662.7	673.8	1.7
17. Floor Coverings	583.2	602.1	3.2
18. Housewares	816.8	807.8	–1.1
19. Major Appliances	243.4	236.9	–2.7
20. Radio and Television	74.9	71.0	–5.2
21. Recreation and Education[2]	108.9	103.2	–5.2
22. Home Improvements[2]	131.7	129.9	–1.4
23. Auto Accessories[2]	108.3	107.5	–0.7
Groups 1 – 15: Soft Goods	606.4	605.4	–0.2
Groups 16 – 20: Durable Goods	465.3	458.1	–1.5
Groups 21 – 23: Misc. Goods[2]	111.8	107.6	–3.8
Store Total[3]	556.7	551.9	–0.9

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

DRAFTING INFORMATION

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

Section 1361.—S Corporation Defined

If a taxpayer files a qualified subchapter S subsidiary (QSub) election after the due date for a desired effective date but within 12 months of that due date, may the taxpayer obtain relief under §301.9100 of the regulations without applying for a private letter ruling? See Rev. Proc. 98–55, page 27.

Section 1362.—Election; Revocation; Termination

26 CFR 1.1362–4: Inadvertent terminations.

If a qualified subchapter S trust election or an electing small business trust election is filed after the required due date but within 24 months of that due date, may the beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT) obtain relief under §1362(f) without applying for a private letter ruling? See Rev. Proc. 98–55, page 27.

26 CFR 1.1362–6: Elections and consents.

If a taxpayer files an S corporation election after the statutory due date but within 12 months of that statutory due date, may the taxpayer obtain relief under § 1362(b)(5) of the Internal Revenue Code without applying for a private letter ruling? See Rev. Proc. 98–55, page 27.

Part III. Administrative, Procedural, and Miscellaneous

Cash or Deferred Arrangements; Nondiscrimination

Notice 98–52

I. PURPOSE

This notice provides guidance on the design-based alternative or "safe harbor" methods in § 401(k)(12) and § 401(m)(11) of the Internal Revenue Code for satisfying the § 401(k) and § 401(m) nondiscrimination tests.

Specifically, under this notice:

- A section 401(k) plan generally satisfies the actual deferral percentage ("ADP") test if a prescribed level of safe harbor matching or nonelective contributions are made on behalf of all eligible non-highly compensated employees ("NHCEs") and if employees are provided a timely notice describing their rights and obligations under the plan. See section V.
- Employee notices for the 1999 plan year are not required to be provided before March 1, 1999. See the transition rule in section V.C.2.
- A plan that satisfies the ADP test safe harbor by providing a basic level of safe harbor matching contributions automatically satisfies the actual contribution percentage ("ACP") test with respect to matching contributions. Plans that provide additional matching contributions satisfy the ACP test if matching contributions do not exceed specified limitations. See section VI.
- A special rule allows § 403(b) plans to take advantage of the ACP test safe harbor. See section VI.C.
- Plan amendments needed to implement the safe harbor methods generally may be deferred until the date other SBJPA plan amendments are required (for calendar year plans, December 31, 1999). See section XI.

Among other matters, this notice also addresses the timing of safe harbor contributions (section VII), the interaction of the safe harbor methods with other qualification rules and testing methods (section VIII), and how the safe harbor methods work where an employer maintains multiple CODAs or plans (section IX).

II. BACKGROUND

Section 1433(a) of the Small Business Job Protection Act of 1996 ("SBJPA"), Pub. L. 104–188, added new §§ 401(k)-(12) and 401(m)(11) to the Code, effective for plan years beginning after December 31, 1998, which provide design-based safe harbor methods for satisfying the ADP test contained in § 401(k)(3)(A)(ii) and the ACP test contained in § 401(m)(2). Section 401(k)(12) provides that a cash or deferred arrangement ("CODA") is treated as satisfying the ADP test if the CODA meets certain contribution and notice requirements. Section 401(m)(11) provides that a defined contribution plan is treated as satisfying the ACP test with respect to matching contributions if the plan meets the contribution and notice requirements contained in § 401(k)(12) and, in addition, meets certain limitations on the amount and rate of matching contributions available under the plan.

Previous guidance on other SBJPA amendments to §§ 401(k) and 401(m) was provided in Notice 97–2, 1997–1 C.B. 348, and Notice 98–1, 1998–3 I.R.B. 42.

III. EFFECT ON REGULATIONS

Because of the amendments made to §§ 401(k) and 401(m) by SBJPA, as well as by other recent legislation, certain portions of §§ 1.401(k)–1, 1.401(m)–1 and 1.401(m)–2 of the Income Tax Regulations no longer reflect current law. However, these regulations continue to apply to the extent they are not inconsistent with the Code, Notices 97–2 and 98–1, this notice, and any subsequent guidance.

IV. DEFINITIONS

A. In General

Except as provided in this section IV, any term used in this notice that is defined in Notice 98–1 or the regulations under §§ 401(k) and 401(m) has the same meaning as in Notice 98–1 or those regulations. For example, the definition of "plan" in § 1.401(k)–1(g)(11) applies for purposes of this notice.

B. Compensation

Except as provided in section V.B.1.c.iii, "compensation" for purposes of this notice means compensation as defined in § 1.401(k)–1(g)(2) (which incorporates by reference the definition of compensation in § 414(s) and § 1.414(s)–1); provided, however, that the rule in the last sentence of § 1.414(s)–1(d)(2)(iii) (which generally permits a definition of compensation to exclude all compensation in excess of a specified dollar amount) does not apply in determining the compensation of NHCEs. The annual compensation limit under § 401(a)(17) applies for purposes of the safe harbor methods.

Thus, a uniform definition of compensation described in this section IV.B must be used for purposes of the basic matching formula or an enhanced matching formula under section V.B.1.a, the nonelective contribution requirement under section V.B.2, and the matching contribution limitations under section VI.B. As provided under § 1.401(k)–1(g)(2), an employer may limit the period used to determine compensation for a plan year to that portion of the plan year in which the employee is an eligible employee, provided that this limit is applied uniformly to all eligible employees under the plan for the plan year.

C. Basic Matching Formula

For purposes of this notice, the "basic matching formula" is the formula described in section V.B.1.a.i.

D. Enhanced Matching Formula

For purposes of this notice, an "enhanced matching formula" is a formula described section V.B.1.a.ii.

E. Rate of Elective Contributions

For purposes of this notice, an employee's "rate of elective contributions" means the ratio of an employee's elective contributions under the plan for a plan year to the employee's compensation for that plan year.

F. Rate of Employee Contributions

For purposes of this notice, an employee's "rate of employee contributions" means the ratio of an employee's employee contributions under the plan for a plan year to the employee's compensation for that plan year.

G. Rate of Matching Contributions

For purposes of the ADP test safe harbor under section V, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's elective contributions for that plan year. For purposes of the ACP test safe harbor under section VI, a "rate of matching contributions" means the ratio of matching contributions on behalf of an employee under the plan for a plan year to the employee's respective employee contributions or elective contributions for that plan year.

H. Safe Harbor Matching Contributions and Safe Harbor Nonelective Contributions

For purposes of this notice, safe harbor matching contributions and safe harbor nonelective contributions are matching and nonelective contributions, respectively, that (1) are nonforfeitable within the meaning of § 1.401(k)–1(c), (2) are subject to the withdrawal restrictions of § 401(k)(2)(B) and § 1.401(k)–1(d), and (3) are used to satisfy the safe harbor contribution requirement of section V.B. Accordingly, pursuant to § 401(k)(2)(B) and § 1.401(k)–1(d), such contributions (and earnings thereon) must not be distributable earlier than separation from service, death, disability, an event described in § 401(k)(10), or, in the case of a profit-sharing or stock bonus plan, the attainment of age 59½. Pursuant to § 401(k)(2)(B) and § 1.401(k)-1(d)(2)(ii), hardship is not a distributable event for contributions other than elective contributions.

V. ADP TEST SAFE HARBOR

A. General Rule

A CODA is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)–1(b)(2) for a plan year if, for the entire plan year, the arrangement satisfies the safe harbor contribution requirement of subsection B of this section V and the notice requirement of subsection C of this section V.

B. Safe Harbor Contribution Requirement

The safe harbor contribution requirement of this section V.B is satisfied for a plan year if the plan satisfies either (1) the matching contribution requirement of paragraph 1 of this section V.B or (2) the nonelective contribution requirement of paragraph 2 of this section V.B. Pursuant to § 401(k)(12)(E)(ii), the safe harbor contribution requirement of this section V.B must be satisfied without regard to § 401(l).

1. Matching Contribution Requirement

a. In General

The matching contribution requirement of this section V.B.1 is satisfied if, under the terms of the plan, safe harbor matching contributions under either the basic matching formula or an enhanced matching formula described below are required to be made on behalf of each NHCE who is an eligible employee.

i. Basic Matching Formula

The basic matching formula provides matching contributions on behalf of each NHCE who is an eligible employee in an amount equal to (A) 100 percent of the amount of the employee's elective contributions that do not exceed 3 percent of the employee's compensation and (B) 50 percent of the amount of the employee's elective contributions that exceed 3 percent of the employee's compensation but that do not exceed 5 percent of the employee's compensation.

ii. Enhanced Matching Formula

An enhanced matching formula provides matching contributions on behalf of each NHCE who is an eligible employee under a formula that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been provided under the basic matching formula. In addition, under an enhanced matching formula, the rate of matching contributions may not increase as an employee's rate of elective contributions increases.

b. Limitation on Matching Contributions for HCEs

The matching contribution requirement of this section V.B.1 is not satisfied if, at any rate of elective contributions, the rate of matching contributions that would apply with respect to any highly compensated employee ("HCE") who is an eligible employee is greater than the rate of matching contributions that would apply with respect to any NHCE who is an eligible employee and who has the same rate of elective contributions.

c. Permissible Restrictions on Elective Contributions by NHCEs

The matching contribution requirement of this section V.B.1 is not satisfied if elective contributions by NHCEs are restricted, unless the restrictions are permitted as described below.

i. Restrictions on Election Periods

A plan sponsor may limit the frequency and duration of periods in which eligible employees may make or change cash or deferred elections under a plan, provided that, after receipt of the notice described in subsection C of this section V, an employee has a reasonable opportunity (including a reasonable period) to make or change a cash or deferred election for the plan year. For purposes of the preceding sentence, a 30-day period is deemed to be a reasonable period.

ii. Restrictions on Amount of Elective Contributions

A plan sponsor may limit the amount of elective contributions that may be made by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted (unless the employee is restricted under paragraph 1.c.iv of this section V.B) to make elective contributions in an amount that is at least sufficient to receive the maximum amount of matching contributions available under the plan for the plan year, and the employee is permitted to elect any lesser amount of elective contributions.

iii. Restrictions on Types of Compensation That May be Deferred

A plan sponsor may limit the types of compensation that may be deferred by an eligible employee under a plan, provided that each NHCE who is an eligible employee is permitted to make elective contributions under a definition of compensation that would be a reasonable definition of compensation within the meaning of § 1.414(s)–1(d)(2). (Thus, the definition is not required to satisfy the nondiscrimination requirement of § 1.414(s)-1(d)(3).) However, see section IV.B regarding the definition of compensation for purposes of the basic matching formula or an enhanced matching formula under paragraph 1.a of this section V.B, the nonelective contribution requirement under paragraph 2 of this section V.B, and the matching contribution limitations under section VI.B.

iv. Restrictions Due to Limitations under the Code

A plan sponsor may limit the amount of elective contributions made by an eligible employee under a plan (A) because of the limitations under § 402(g) or § 415 or (B) because, on account of a hardship distribution, an employee's ability to make elective contributions has been suspended for 12 months in accordance with § 1.401(k)–1(d)(2)(iv)(B)(4) or limited in accordance with § 1.401(k)–1(d)(2)(iv)(B)(3).

2. Nonelective Contribution Requirement

The nonelective contribution requirement of this section V.B.2 is satisfied if, under the terms of the plan, the employer is required to make a safe harbor nonelective contribution on behalf of each NHCE who is an eligible employee equal to at least 3 percent of the employee's compensation.

3. Examples

The safe harbor contribution requirement of this section V.B is illustrated by the following examples:

Example 1

(a) Beginning January 1, 1999, Employer A maintains Plan L covering employees (including HCEs and NHCEs) in Divisions D and E. Plan L contains a CODA and provides a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation. For purposes of the matching contribution formula, compensation is defined as all compensation within the meaning of § 415(c)(3) (a definition that satisfies § 414(s)). Also, each employee is permitted to make elective contributions from all compensation within the meaning of § 415(c)(3) and may change a cash or deferred election at any time. Plan L limits the amount of an employee's elective contributions for purposes of § 402(g) and § 415, and, in the case of a hardship distribution, suspends an employee's ability to make elective contributions for 12 months in accordance with § 1.401(k)–1(d)(2)(iv)(B)(4) and limits an employee's elective contributions in accordance with § 1.401(k)–1(d)(2)(iv)(B)(3). All contributions under Plan L are nonforfeitable and are subject to the withdrawal restrictions of § 401(k)(2)(B). Plan L provides for no other contributions and Employer A maintains no other plans. Plan L is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, matching contributions under Plan L are safe harbor matching contributions because they are nonforfeitable, are subject to the withdrawal restrictions of § 401(k)(2)(B), and are used to satisfy the safe harbor contribution requirement of section V.B.

(c) Plan L's formula is an enhanced matching formula because each NHCE who is an eligible employee receives matching contributions at a rate that, at any rate of elective contributions, provides an aggregate amount of matching contributions at least equal to the aggregate amount of matching contributions that would have been received under the basic matching formula, and the rate of matching contributions does not increase as the rate of an employee's elective contributions increases.

(d) Plan L satisfies the safe harbor contribution requirement of this section V.B because safe harbor matching contributions under an enhanced matching formula are required to be made on behalf of each NHCE who is an eligible employee.

(e) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would also satisfy the ACP test safe harbor. See section VI.)

Example 2

(a) The facts are the same as in Example 1, except that instead of providing a required matching contribution equal to 100 percent of each eligible employee's elective contributions up to 4 percent of compensation, Plan L provides a matching contribution equal to 150 percent of each eligible employee's elective contributions up to 3 percent of compensation.

(b) Plan L's formula is an enhanced matching formula and Plan L satisfies the safe harbor contribution requirement of this section V.B.

(c) Plan L would satisfy the ADP test safe harbor if Plan L also satisfied the notice requirement of subsection C of this section V. (Plan L then would also satisfy the ACP test safe harbor. See section VI.)

Example 3

(a) The facts are the same as in Example 1, except that instead of permitting each employee to make elective contributions from compensation within the meaning of § 415(c)(3), each employee's elective contributions under Plan L are limited to 15 percent of the employee's "basic compensation." Basic compensation is defined under Plan L as compensation within the meaning of § 415(c)(3), but excluding overtime pay.

(b) The definition of basic compensation under Plan L is a reasonable definition of compensation within the meaning of § 1.414(s)–1(d)(2).

(c) Plan L will not fail to satisfy the safe harbor contribution requirement of this section V.B merely because Plan L limits the amount of elective contributions and the types of compensation that may be deferred by eligible employees, provided that each NHCE who is an eligible employee may make elective contributions equal to at least 4 percent of the employee's compensation under § 415(c)(3) (that is, the amount of elective contributions that is sufficient to receive the maximum amount of matching contributions available under the plan).

Example 4

(a) The facts are the same as in Example 1, except that Plan L provides that only employees employed on the last day of the plan year will receive a safe harbor matching contribution.

(b) Even if the section 401(m) plan satisfies the minimum coverage requirements of § 410(b)(1) taking into account this last-day requirement, Plan L would not satisfy the safe harbor contribution requirement of this section V.B because safe harbor matching contributions are not made on behalf of all NHCEs who are eligible employees and who make elective contributions.

(c) The result would be the same if, instead of providing safe harbor matching contributions under an enhanced formula, Plan L provides for a 3-percent safe harbor nonelective contribution that is restricted to eligible employees under the CODA who are employed on the last day of the plan year.

Example 5

(a) The facts are the same as in Example 1, except that instead of providing safe harbor matching contributions under the enhanced matching formula to employees in both Divisions D and E, employees in Division E are provided safe harbor matching contributions under the basic matching formula, while matching contributions continue to be provided to employees in Division D under the enhanced matching formula.

(b) Even if Plan L satisfies § 1.401(a)(4)–4 with respect to each rate of matching contributions available to employees under the plan, the plan would fail to satisfy the safe harbor contribution requirement of this section V.B because the rate of matching contributions with respect to HCEs in Division D at a rate of elective contributions between 3 and 5 percent would be greater than that with respect to NHCEs in Division E at the same rate of elective contributions. For example, an HCE in Division D who would have a 4-percent rate of elective contributions would have a rate of matching contributions of 100 percent while an NHCE in Division E who would have the same rate of elective contributions would have a lower rate of matching contributions.

C. Notice Requirement

The notice requirement of this section V.C is satisfied if each eligible employee for the plan year is given written notice of the employee's rights and obligations under the plan and the notice satisfies the content requirement of paragraph 1 of this section V.C and the timing requirement of paragraph 2 of this section V.C.

1. Content Requirement

a. General Rule

The content requirement of this section V.C.1 is satisfied if the notice (1) is sufficiently accurate and comprehensive to inform the employee of the employee's rights and obligations under the plan and (2) is written in a manner calculated to be understood by the average employee eligible to participate in the plan. For purposes of the preceding sentence, a notice is not considered sufficiently accurate and comprehensive unless the notice accurately describes (i) the safe harbor matching or nonelective contribution formula used under the plan (including a description of the levels of matching contributions, if any, available under the plan); (ii) any other contributions under the plan (including the potential for discretionary matching contributions) and the conditions under which such contributions are made; (iii) the plan to which safe harbor contributions will be made (if different than the plan containing the CODA); (iv) the type and amount of compensation that may be deferred under the plan; (v) how to make cash or deferred elections, including any administrative requirements that apply to such elections; (vi) the periods available under the plan for making cash or deferred elections; and (vii) withdrawal and vesting provisions applicable to contributions under the plan.

b. 1999 Transition Relief for Content Requirement

For a plan adopting the safe harbor provisions for a plan year that begins before January 1, 2000, a notice will not fail to satisfy the content requirement for that plan year merely because the notice does not include all of the items listed in paragraph 1.a of this section V.C, provided that the notice satisfies a reasonable good faith interpretation of the notice requirements under §§ 401(k)(12) and 401(m)(11).

2. Timing Requirement

a. General rule

The timing requirement of this section V.C.2 is satisfied if the notice is provided within a reasonable period before the beginning of the plan year (or, in the year an employee becomes eligible, within a reasonable period before the employee becomes eligible). The determination of whether a notice satisfies the timing requirement of this section V.C.2 is based on all of the relevant facts and circumstances.

b. Deemed Satisfaction of Timing Requirement

The timing requirement of this section V.C.2 is deemed to be satisfied if at least 30 days (and no more than 90 days) before the beginning of each plan year, the notice is given to each eligible employee for the plan year. In the case of an employee who does not receive the notice within the period described in the previous sentence because the employee becomes eligible after the 90th day before the beginning of the plan year, the timing requirement is deemed to be satisfied if the notice is provided no more than 90 days before the employee becomes eligible (and no later than the date the employee becomes eligible). Thus, for example, the preceding sentence would apply in the case of any employee eligible for the first plan year under a newly established section 401(k) plan, or would apply in the case of the first plan year in which an employee becomes eligible under an existing section 401(k) plan.

c. 1999 Transition Relief for Timing Requirement

For a plan year that begins on or before April 1, 1999, the notice described in this section V.C satisfies the timing requirement for that plan year (with respect to an existing section 401(k) plan or a newly established one) if the notice is given on or before March 1, 1999. However, in order to satisfy the ADP or ACP test safe harbor for the plan year, a plan that is using the transition relief provided under this section V.C.2.c still must satisfy the otherwise applicable requirements of this Notice 98-52 with respect to the entire plan year.

VI. ACP TEST SAFE HARBOR

A. General Rule

A defined contribution plan is treated as satisfying the ACP test under § 401(m)(2) and § 1.401(m)-1(b) with respect to matching contributions for a plan year if, for the entire plan year, (i) each NHCE eligible to receive an allocation of matching contributions under the plan is also an eligible employee under a CODA that satisfies the ADP test safe harbor of section V and (ii) the plan satisfies the matching contribution limitations of subsection B of this section VI. See section VIII.F.1 regarding the continued application of the ACP test to employee contributions.

B. Matching Contribution Limitations

1. Harbor Matching Contributions Under Basic Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if (i) the plan satisfies the matching contribution requirement of section V.B.1 using the basic matching formula and (ii) no other matching contributions are provided under the plan.

2. Safe Harbor Matching Contributions Under an Enhanced Matching Formula

A plan satisfies the matching contribution limitations of this section VI.B if (i) the plan satisfies the matching contribution requirement of section V.B.1 using an enhanced matching formula under which matching contributions are only made with respect to elective contributions that do not exceed 6 percent of the employee's compensation and (ii) no other matching contributions are provided under the plan.

3. Other Matching Contributions

In the case of any other plan, the matching contribution limitations of this section VI.B are satisfied if, under the plan, (i) matching contributions are not made with respect to employee contributions or elective contributions that in the aggregate exceed 6 percent of the employee's compensation, (ii) the rate of matching contributions does not increase as the rate of employee contributions or elective contributions increases, and (iii) at any rate of employee contributions or elective contributions, the rate of matching contributions that would apply with respect to any HCE who is an eligible employee is no greater than the rate of matching contributions that would apply with respect to an NHCE who is an eligible employee and who has the same rate of employee contributions or elective contributions. If a plan provides matching contributions with respect to employee contributions or elective contributions, those employee contributions or elective contributions may be restricted only to the extent permitted under section V.B.1.c.

4. Matching Contributions Generally Must be Required Under Plan Terms

a. ADP Test Safe Harbor

As provided under section V.B.1.a, a matching contribution may be taken into account in determining whether the matching contribution requirement of the ADP test safe harbor is satisfied only if the contribution is required to made under the terms of a plan. Even though matching contributions made at the employer's discretion may not be taken into account in determining whether the matching contribution requirement of section V.B.1 is satisfied, a plan that satisfies the safe harbor contribution requirement of section V.B will not fail to satisfy the ADP test safe harbor merely because additional matching contributions are made at the employer's discretion.

b. ACP Test Safe Harbor

A plan fails to satisfy the ACP test safe harbor for a plan year if the plan provides for matching contributions made at the employer's discretion on behalf of any employee that, in the aggregate, could exceed a dollar amount equal to 4 percent of the employee's compensation. This limitation on matching contributions made at the employer's discretion does not apply to plan years beginning before January 1, 2000.

C. Special Rule for Matching Contributions Under a § 403(b) Plan

For purposes of § 403(b)(12)(A)(i), a § 403(b) plan is treated as satisfying the requirements of § 401(m) with respect to matching contributions if the plan satisfies the safe harbor contribution requirement of section V.B, the notice requirement of section V.C, and the matching contribution limitations of subsection B of this section VI. For purposes of applying the requirements of section V and this section VI, salary reduction contributions under a § 403(b) plan are treated as elective contributions under a CODA.

D. Examples

The following examples illustrate the requirements of the ACP test safe harbor described in this section VI:

Example 1

(a) An employer's only plan, Plan M, contains a CODA that satisfies the ADP test safe harbor using safe harbor matching contributions under the basic matching formula. No contributions, other than elective contributions and contributions under the basic matching formula, are made to Plan M.

(b) Because the CODA under Plan M satisfies the ADP test safe harbor using the basic matching formula and Plan M provides for no other matching contributions, Plan M automatically satisfies the ACP test safe harbor.

Example 2

(a) Beginning January 1, 2000, Employer B maintains Plan N, the only plan maintained by Employer B. Plan N contains a CODA that satisfies the ADP test safe harbor using a 3-percent safe harbor nonelective contribution. Plan N also provides matching contributions equal to 50 percent of each eligible employee's elective contributions up to 6 percent of compensation. Under Plan N, elective contributions are limited to 10 percent of an employee's compensation and are limited in accordance with § 402(g) and § 415. Under Plan N, an employee may change a cash or deferred election at any time. Plan N provides a definition of compensation that satisfies § 414(s) and that same definition is used for all purposes under Plan N. Matching contributions under Plan N are fully vested after 3 years of service. No other matching contributions are provided for under Plan N. The plan is maintained on a calendar-year basis and all contributions for a plan year are made within 12 months after the end of the plan year.

(b) Based on these facts, Plan N satisfies the ACP test safe harbor with respect to matching contributions because each NHCE eligible to receive an allocation of matching contributions under Plan N is also an eligible employee under a CODA that satisfies the ADP test safe harbor of section V and because the matching contribution limitations of subsection B of this section VI are satisfied.

Example 3

(a) The facts are the same as in Example 2, except that Plan N also provides matching contributions equal to 50 percent of each eligible employee's employee contributions up to 6 percent of compensation.

(b) Plan N does not satisfy the matching contribution limitations of subsection B of this section VI because matching contributions can be made with respect to elective contributions and employee contributions that, in the aggregate, equal 12 percent of compensation (and thus exceed 6 percent of compensation).

Example 4

(a) The facts are the same as in Example 2, except that Plan N also provides that Employer B, in its discretion, may make additional matching contributions up to 50 percent of each eligible employee's elective contributions that do not exceed 6 percent of compensation.

(b) Plan N does not fail to satisfy the ACP test safe harbor on account of discretionary matching contributions, because, under Plan N, the amount of discretionary matching contributions cannot exceed 4 percent of an employee's compensation.

VII. TIMING OF PLAN CONTRIBUTIONS

A. In General

As provided in subsections B and C of this section VII, matching and nonelective contributions under a plan using the safe harbor methods must be made to the plan within the same time period that would apply if these contributions were made to a plan using the current year testing method for ADP or ACP testing purposes (that is, no later than 12 months after the close of the plan year).

Matching and nonelective contributions also may be made from time to time during the plan year, instead of at one time after the close of the plan year. Regardless of the timing of employer contributions, however, the total amount of matching or nonelective contributions for the plan year still must satisfy the requirements of sections V and VI, taking into account the total amount of compensation for the plan year, in order for a CODA to satisfy the ADP test safe harbor.

B. Contributions Under the ADP Test Safe Harbor

A CODA will not satisfy the ADP test safe harbor for a plan year unless safe harbor matching and nonelective contributions needed to satisfy the safe harbor contribution requirement of section V.B are made in accordance with the allocation and timing rules of § 1.401(k)–1(b)(4).

C. Matching Contributions Under the ACP Test Safe Harbor

Matching contributions are taken into account for a plan year under the ACP test safe harbor of section VI in accordance with the allocation and timing rules of § 1.401(m)-1(b)(4)(ii)(A).

VIII. INTERACTION WITH OTHER RULES AND TESTING METHODS

A. In General

A CODA that is treated as satisfying the ADP test under § 401(k)(3)(A)(ii) and § 1.401(k)-1(b)(2) will not be treated as a qualified CODA unless the arrangement satisfies the other requirements of § 401(k). For example, under § 401(k)-(3)(A)(i), the group of eligible employees under the section 401(k) plan must satisfy the requirements of § 410(b), under § 401(k)(4)(A), benefits (other than matching contributions) must not be contingent on an election to defer, and elective contributions must satisfy the allocation and timing rules of § 1.401(k)–1(b)(4). A plan that satisfies the ADP or ACP test safe harbor must satisfy all other qualification requirements of the Code that are applicable to the plan, such as the nondiscriminatory availability of benefits, rights, and features under § 401(a)(4) and the limitations of §§ 401(a)(17), 401(a)(30) and 415.

B. Use of Safe Harbor Nonelective Contributions to Satisfy Other Nondiscrimination Tests

A safe harbor nonelective contribution used to satisfy the nonelective contribution requirement under section V.B.2 may also be taken into account for purposes of determining whether a plan satisfies § 401(a)(4). Thus, these contributions are not subject to the limitations on qualified nonelective contributions under § 1.401(k)–1(b)(5)(ii), but are subject to the rules generally applicable to nonelective employer contributions under § 401(a)(4). See § 1.401(a)(4)–1(b)(2)(ii). However, pursuant to § 401(k)(12)(E)(ii), to the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor nonelective contributions may not be taken into account under any plan for purposes of § 401(l) (including the imputation of permitted disparity under § 1.401(a)(4)–7).

C. Top-Heavy Rules

1. Safe Harbor Nonelective Contributions

Safe harbor nonelective contributions may be counted under § 416 toward the minimum contribution requirement for top-heavy plans. Thus, if a plan allocates to all eligible employees a 3-percent safe harbor nonelective contribution, the plan generally would also satisfy the top-heavy minimum contribution requirement. See § 1.416–1, M-18 for a similar rule applicable to qualified nonelective contributions.

2. Safe Harbor Matching Contributions

If a plan uses contributions allocated to employees on the basis of elective contributions or employee contributions to satisfy the top-heavy minimum contribution requirement under § 416, these contributions are not treated as matching contributions for purposes of §§ 401(k) and 401(m). Therefore, safe harbor matching contributions may not be counted toward the minimum contribution requirement for top-heavy plans under § 416. See § 1.416–1, M–19.

D. Qualified Matching Contributions and Qualified Nonelective Contributions

To the extent they are needed to satisfy the safe harbor contribution requirement of section V.B, safe harbor matching and nonelective contributions may not be used as qualified matching contributions and qualified nonelective contributions, respectively, under any plan for any plan year. For example, if a plan satisfies the safe harbor contribution requirement using a safe harbor nonelective contribution by allocating a 7-percent safe harbor nonelective contribution to all eligible employees, contributions in an amount equal to the first 3 percent of each employee's compensation may not be used as a qualified nonelective contribution under the ACP test. However, safe harbor nonelective contributions in an amount equal to the remaining 4 percent of each employee's compensation may be used to satisfy the ACP test (subject to the requirements of § 1.401(m)–1(b)(5)).

E. Testing Methods Under Notice 98–1

For purposes of Notice 98–1, a plan that uses the safe harbor methods to satisfy the ADP or ACP test for a plan year is treated as using the current year testing method for that year and, thus, is subject to the rules contained in section VII of Notice 98–1 (relating to changes from current year to prior year testing).

In addition, in the case of a plan that is not maintained on a calendar plan year basis, the anti-abuse provision of section VIII of Notice 98–1 applies in a similar manner to changes between the safe harbor methods and the current or prior year testing method.

F. Continued Application of the ACP Test to Certain Contributions

1. Employee Contributions

Even if a defined contribution plan satisfies the ACP test safe harbor of section VI with respect to matching contributions, the plan still must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F with respect to employee contributions made under the plan.

2. Matching Contributions that Fail to Satisfy the ACP Test Safe Harbor

If a plan satisfies the ADP test safe harbor of section V.A, but fails to satisfy the ACP test safe harbor with respect to matching contributions under the plan, then the plan must satisfy the ACP test in the manner described in paragraph 3 of this section VIII.F.

3. Special Rules for ACP Test

If paragraph 1 or 2 of this section VIII.F applies, then the plan must satisfy the ACP test under § 401(m)(2), and under § 1.401(m)–1(b), as modified by Notices 97–2 and 98–1, using the current year testing method. However, in applying the ACP test, an employer may elect to disregard with respect to all eligible employees (i.e., all HCEs and NHCEs) (1) all matching contributions, if the ACP test safe harbor of section VI is satisfied or (2) matching contributions that do not exceed 4 percent of each employee's compensation, if the matching contribution requirement of section V.B.1 is satisfied. Except as otherwise provided in section VIII.D, qualified nonelective contributions may be treated as matching contributions to the extent permitted under § 1.401(m)–1(b)(5). Finally, in applying the ACP test (i) matching contributions may not be treated as elective contributions under § 401(k)(3)(D) to a CODA that satisfies the ADP test safe harbor (and thus excluded from the ACP test under § 401(m)(3)) and (ii) elective contributions under a CODA that satisfies the ADP test safe harbor may not be treated as matching contributions under § 401(m)(3).

G. Multiple Use Test

The restrictions on multiple use under § 1.401(m)–2 do not apply to a CODA that satisfies the ADP test safe harbor. In addition, the restrictions on multiple use under § 1.401(m)–2 do not apply to a defined contribution plan that satisfies the ACP test safe harbor, if the plan does not permit employee contributions. In determining whether multiple use of the alternative limitation under § 401(k)(3)(A)(ii)(II) or § 401(m)(2)(A)(ii) occurs with respect to another plan of an employer, (1) a CODA that satisfies the ADP test safe harbor and (2) a defined contribution plan that satisfies the ACP test safe harbor and does not permit employee contributions, are disregarded for purposes of § 1.401(m)–2(b). In the case of a defined contribution plan to which subsection F.1 or F.2 of this section VIII applies (that is, a defined contribution plan that satisfies the ACP test safe harbor but permits employee contributions, or a defined contribution plan that fails to satisfy the ACP test safe harbor), the special rules of subsection F.3 of this section VIII (relating to ACP testing) also apply for purposes of § 1.401(m)–2(b) in determining whether the multiple use of the alternative limitation occurs.

H. Early Participation Rules

Sections 401(k)(3)(F) and 401(m)(5)-(C), which provide alternative nondiscrimination rules for certain plans that provide for early participation, do not apply for purposes of the safe harbor methods. However, see section IX.B.1 for application of the § 410(b)(4)(B) rule permitting the separate testing of employees who satisfy age and service conditions under the plan that are lower than the greatest age and service conditions permitted under § 410(a).

IX. MULTIPLE CODAS OR MULTIPLE PLANS

A. Satisfying Safe Harbor Contribution Requirement Under Another Defined Contribution Plan

1. In General

Safe harbor matching or nonelective contributions may be made to the plan that contains the CODA or to another defined contribution plan that satisfies § 401(a) or § 403(a). If safe harbor contributions are made to another defined contribution plan, the safe harbor contribution requirement of section V.B must be satisfied in the same manner as if the contributions were made to the plan that contains the CODA. Consequently, each employee eligible under the plan containing the CODA must be eligible under the same conditions under the other defined contribution plan.

2. Plan Year Requirement

In order for safe harbor contributions to be made to another defined contribution plan, that plan must have the same plan year as the plan containing the CODA. However, for plan years of plans containing CODAs beginning before January 1, 2000, contributions used to satisfy the safe harbor contribution requirement of section V.B for a CODA also may be made to another defined contribution plan that does not have the same plan year as the plan containing the CODA, provided that the safe harbor contribution is allocated as of a date within the plan year of the plan containing the CODA and is made no later than 12 months after the close of that plan year.

3. Section 410(b) Aggregation Not Required

In order for safe harbor contributions to be made to another defined contribution plan, it is not necessary that the other plan be capable of being aggregated with the plan containing the CODA for purposes of § 410(b). Therefore, notwithstanding §§ 1.410(b)–7(c)(2) and 54.4975–11(e), a contribution to an ESOP may be used to satisfy the safe harbor contribution requirement of section V.B for a CODA that is not part of the ESOP.

4. Contributions Used Only Once

Safe harbor matching or nonelective contributions cannot be used to satisfy the safe harbor contribution requirement of section V.B with respect to more than one plan.

B. Aggregation and Disaggregation Rules

1. Plans

The rules that apply for purposes of aggregating and disaggregating CODAs and plans under §§ 401(k) and 401(m) also apply for purposes of §§ 401(k)(12) and 401(m)(11), respectively. See §§ 1.401(k)–1(b)(3) and 1.401(m)–1(b)(3).

Accordingly, all CODAs included in a plan are treated as a single CODA that must satisfy the safe harbor contribution requirement of section V.B and the notice requirement of section V.C. Moreover, two plans (within the meaning of § 1.410(b)–7(b)) that are treated as a single plan pursuant to the permissive aggregation rules of § 1.410(b)–7(d) are treated as a single plan for purposes of the safe harbor methods. Conversely, a plan (within the meaning of § 414(l)) that includes a CODA covering both collectively bargained employees and noncollectively bargained employees is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor. Similarly, if, pursuant to § 410(b)(4)(B), an employer applies § 410(b) separately to the portion of a plan (within the meaning of § 414(l)) that benefits only employees who satisfy age and service conditions under the plan that are lower than the greatest minimum age and service conditions permitted under § 410(a), the plan is treated as two separate plans for purposes of § 401(k), and the ADP test safe harbor need not be satisfied with respect to both plans in order for one of the plans to take advantage of the ADP test safe harbor.

2. Highly Compensated Employees

In accordance with §§ 401(k)(3) and 401(m)(2), elective or matching contributions under a plan made on behalf of an HCE who is eligible to participate in more than one plan of the same employer providing such contributions must generally be aggregated and treated as made under each of the plans, even if one or more of the plans is intended to satisfy the ADP or ACP test safe harbor. Thus, for example, if an HCE is simultaneously an eligible employee under two plans maintained by an employer for a plan year, only one of which one is intended to satisfy the ADP and ACP tests using the safe harbor methods, and the matching contribution formula of the plan that is not using the safe harbor methods provides greater matching contributions than the formula under the plan that is intended to satisfy the ADP and ACP tests using the safe harbor methods, the rules in sections V.B.1.b and VI.B.3 (prohibiting an HCE from receiving a greater rate of matching contributions than an NHCE) could be violated. These issues could also arise, for example, when an HCE is transferred from a plan maintained for one group of employees to a plan maintained for another group of employees.

X. PLAN YEARS OF FEWER THAN 12 MONTHS

A plan will fail to satisfy the ADP test safe harbor or the ACP test safe harbor for a plan year unless (i) the plan year is 12 months long or (ii) in the case of the first plan year of a newly established plan (other than a successor plan), the plan year is at least 3 months long (or, any shorter period in the case of a newly established employer that establishes the plan as soon as administratively feasible after the employer comes into existence).

XI. PLAN PROVISIONS RELATING TO SAFE HARBORS

A. General Rules

1. Plan Must Include Safe Harbor Provisions

Sections 1.401(k)–1(b)(2)(iii) and 1.401(m)–1(b)(2) require that a plan to which § 401(k) or § 401(m) applies provide that the ADP or ACP test will be met. Because, effective for plan years beginning after December 31, 1998, a plan may use the SIMPLE 401(k) plan formula or safe harbor provisions as alternatives to the ADP and ACP tests, a plan must specify which of these alternatives it is using. Generally, a plan sponsor that intends to use the safe harbor provisions for a plan year must adopt those provisions before the first day of that plan year. However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

2. Safe Harbor Contributions Made to Another Plan

If, pursuant to section IX.A, safe harbor matching or nonelective contributions will be made to another plan, the name of the other plan must be specified in the plan containing the CODA. Moreover, if safe harbor matching or nonelective contributions will be made to another plan for a plan year, the other plan must also adopt, before the first day of that plan year, provisions specifying that the safe harbor contributions will be made and providing for the withdrawal and vesting restrictions required by § 401(k)(12)(E)(i). However, see section XI.B for the remedial amendment period applicable to plan changes incorporating the safe harbor provisions.

3. Disaggregated Plans

If a plan, within the meaning of § 414(l), is composed of disaggregated plans under § 1.410(b)–7(c), the plan provisions must specify which disaggregated plans are subject to the safe harbor provisions.

B. Remedial Amendment Period

Section 1.401(b)–1T(b)(3) authorizes the Commissioner to designate a plan provision as a disqualifying provision that either (1) results in the failure of the plan to satisfy the qualification requirements of the Code by reason of a change in those requirements or (2) is integral to a qualification requirement that has been changed. Section 1.401(b)–1T(c)(3) authorizes the Commissioner, in the case of a disqualifying provision designated as described in the preceding sentence, to impose limits and provide additional rules regarding the amendments that may be made with respect to that disqualifying provision.

Pursuant to § 1.401(b)-1T(b)(3) and (c)(3), a plan provision is hereby designated as a disqualifying provision if the plan provision is integral to a qualification requirement changed by a provision of SBJPA that becomes effective on the first day of the first plan year beginning after December 31, 1998, provided that the following conditions are satisfied. First, the plan provision must be amended to reflect the change made by SBJPA by no later than the last day of the first plan year beginning after December 31, 1998. (If an employer or plan administrator files a request for a determination letter on the qualified status of a plan by the last day of the first plan year beginning after December 31, 1998, then the date by which the plan provision must be amended shall be extended through the 91st day following the applicable date under § 1.401(b)–1(e)(3)(i) or (ii).) Second, the plan provision as amended must be effective as of the first day of the first plan year beginning after December 31, 1998. Thus, if a plan uses the safe harbor methods for the plan year beginning in 1999, the plan generally must be amended no later than the end of that plan year, retroactive to the first day of that year, to reflect the safe harbor methods. This remedial amendment period also applies to a plan amendment reflecting the use of the early participation rules under §§ 401(k)(3)(F) and 401(m)(5)(C).

The preceding paragraph does not permit a CODA to be adopted retroactively. See § 1.401(k)–1(a)(3)(ii).

A plan amendment described in this section XI.B shall not be treated as violating the requirements of § 411(d)(6) merely because the plan amendment imposes the withdrawal restrictions required by § 401(k)(12)(E)(i), provided that those withdrawal restrictions do not apply with respect to contributions allocated as of a date before the first day of the first plan year beginning after December 31, 1998.

REQUEST FOR COMMENTS

The Service and Treasury invite comments and suggestions concerning the guidance provided in this notice. Comments are specifically requested as to whether there are circumstances (in addition to the first plan year of a newly established plan) in which the use of the safe harbor methods would be appropriately allowed for a plan year of less than 12 months (e.g., certain corporate merger or acquisition transactions involving a plan sponsor maintaining a plan using the safe harbor methods, if appropriate conditions are satisfied).

Comments can be addressed to CC:DOM:CORP:R (Notice 98–52), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, comments may be hand delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (Notice 98–52), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may transmit comments electronically via the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

PAPERWORK REDUCTION ACT

The collection of information contained in this notice has been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1624.

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

The collection of information in this notice is in section V.C, "Notice Requirement," and section XI, "Plan Provisions Relating to Safe Harbors." The collection of information is required to obtain a benefit. The likely respondents are businesses or other for-profit institutions, and not-for-profit institutions.

The estimated total annual reporting/recordkeeping burden is 80,000 hours.

The estimated annual burden per respondent/recordkeeper is 1 hour and 20 minutes. The estimated number of respondents/recordkeepers is 60,000.

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.

Drafting Information

The principal author of this notice is Roger Kuehnle of the Employee Plans Division. For further information regarding this notice, please contact the Employee Plans Division's taxpayer assistance telephone service at (202) 622-6074/6075 (not toll-free numbers), between the hours of 1:30 and 3:30 p.m. Eastern Time, Monday through Thursday.

1999 Limitations Adjusted As Provided in Section 415(d), Etc.[1]

Notice 98–53

Section 415 of the Internal Revenue Code (the Code) provides for dollar limitations on benefits and contributions under qualified plans. Section 415 also requires that the Commissioner annually adjust these limits for cost-of-living increases. Other limitations applicable to deferred compensation plans are also affected by these adjustments.

Effective January 1, 1999, the limitation for the annual benefit under § 415(b)(1)(A) for defined benefit plans remains unchanged at $130,000. For participants who separated from service before January 1, 1999, the limitation for defined benefit plans under § 415(b)-(1)(B) is computed by multiplying the participant's compensation limitation, as adjusted through 1998 by 1.0160. The limitation for defined contribution plans under § 415(c)(1)(A) remains unchanged at $30,000.

The Code provides that various other dollar amounts are to be adjusted at the same time and in the same manner as the dollar limitation of § 415(b)(1)(A) is adjusted. These dollar amounts and the adjusted amounts are as follows:

The limitation on the exclusion for elective deferrals under § 402(g)(1) remains unchanged at $10,000.

The dollar amount under § 409(o)(1)(C)(ii) for determining the maximum account balance in an employee stock ownership plan subject to a 5-year distribution period is increased from $725,000 to $735,000, while the

[1]Based on News Release IR-98-63, dated October 23, 1998.

dollar amount used to determine the lengthening of the 5-year distribution remains unchanged at $145,000.

The limitation used in the definition of a highly compensated employee under § 414(q)(1)(B) remains unchanged at $80,000.

The annual compensation limit under §§ 401(a)(17) and 404(l) remains unchanged at $160,000. The annual compensation limit under § 401(a)(17) for eligible participants in certain governmental plans that, under the plan as in effect on July 1, 1993, allowed cost-of-living adjustments to the compensation limitation under the plan under § 401(a)(17) to be taken into account, is increased from $265,000 to $270,000.

The compensation amount under § 408(k)(2)(C) regarding simplified employee pension plans (SEPs) remains unchanged at $400. The compensation amount under § 408(k)(3)(C) for SEPs remains unchanged at $160,000.

The limitation under § 408(p)(2)(A) regarding simple retirement accounts remains unchanged at $6,000.

The limitation on deferrals under § 457(b)(2) and (c)(1) concerning eligible deferred compensation plans of state and local governments and of tax-exempt organizations remains unchanged at $8,000.

The compensation amounts under § 1.61–21(f)(5)(i) and (iii) of the Income Tax Regulations concerning the definition of "control employee" for fringe benefit valuation purposes are $70,000 and $145,000, respectively.

Administrators of defined benefit or defined contribution plans that have received favorable determination letters should not request new determination letters solely because of yearly amendments to adjust maximum limitations in the plans.

Returns Relating to Interest on Education Loans

Notice 98–54

PURPOSE

This notice modifies Notice 98–7, 1998–3 I.R.B. 54, which describes the information reporting requirements under § 6050S of the Internal Revenue Code for 1998 that apply in the case of payments of interest on qualified education loans. Specifically, this notice provides that no information reporting is required with respect to "mixed use" loans in light of amendments made to § 221(e)(1) by the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Pub. L. No. 105–206, § 6004(b)(1), 112 Stat. 792. This notice also provides that the Internal Revenue Service and the Treasury Department are extending the application of Notice 98–7 to information reporting required under § 6050S for 1999.

BACKGROUND

Section 6050S, as enacted by the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, § 202(c), 111 Stat. 808, requires the filing of information returns by persons who receive payments of interest that may be deductible as interest on a qualified education loan ("payees"). Section 6050S(e) provides that, except as provided in regulations, the term "qualified education loan" has the meaning given such term by § 221(e)(1). Section 6050S requires that payees file the specified information returns with the Service and provide a corresponding statement to the individuals named on the information return ("payor") showing the information that has been reported.

The requirements for reporting qualified education loan interest under § 6050S are generally described in Notice 98–7, along with specific information reporting requirements for 1998. Section D of the Discussion portion of Notice 98–7 provides a rule for reporting payments of interest made on or after January 1, 1998, on mixed use loans or revolving accounts, such as credit card accounts. Payments of interest on these loans are treated under Notice 98–7 as interest paid with respect to a qualified education loan (and must be reported as such) only if the mixed use loan or revolving account is certified by the payor to be, in part, a qualified education loan, and the payee has a reasonable method for allocating the interest payments to the part of the loan that is certified to be a qualified education loan. In addition, Section E of the Discussion provides that, with respect to loans made on or after January 1, 1998, that are secured by real property, if a payor certifies all or part of such a loan as a qualified education loan, only the certified portion of the loan may be treated as a qualified education loan for purposes of information reporting. The remaining portion must be treated as a mortgage subject to information reporting under § 6050H.

DISCUSSION

Section 221(e)(1), as amended by RRA 1998, provides that the term "qualified education loan" means any indebtedness incurred by the taxpayer *solely* to pay qualified higher education expenses. The amendment to § 221(e)(1) is effective as if included in the Taxpayer Relief Act of 1997 and applies to interest payments due and paid after December 31, 1997. Thus, the payee must not report under § 6050S information on mixed use loans (whether or not secured by real property) because they are not qualified education loans under § 221(e)(1) as amended. However, information reporting under § 6050S continues to be required for any loan (including a loan secured by real property) or revolving account, such as credit card account, that the payor certifies is used *solely* for the purpose of paying qualified higher education expenses. The payee may rely on this certification when filing Form 1098–E, Student Loan Interest Statement, for 1998 and need not verify the payor's actual use of the funds. In all other respects, the requirements of § 6050S with respect to qualified education loan interest reporting for 1998 remain the same as described in Notice 98–7.

The Service is currently revising Form W–9S, Request for Student's or Borrower's Social Security Number and Certification, to remove the certification for mixed use loans. In addition, payees should disregard the instructions regarding mixed use loans and revolving accounts, which are found in the Form 1098-E section of the 1998 Instructions for Forms 1099, 1098, 5498, and W–2G. Those instructions will be revised for 1999.

The Treasury Department intends to issue regulations soon on the information reporting requirements of § 6050S. Pending issuance of those regulations, the Service is extending the application of Notice

98–7, as modified by this notice, for an additional year, *i.e.*, to information reporting required under § 6050S for 1999.

For 1999, payees must follow the rules provided in Notice 98–7, as modified by this notice, for information reporting under § 6050S. For example, a payee that receives payments of interest on a qualified education loan in 1999 must file a Form 1098–E that includes the same information that was required by Notice 98–7, as modified by this notice. The Forms 1098-E for 1999 must be filed with the Service by February 28, 2000, if filed on paper or by magnetic media, or by March 31, 2000, if filed electronically. A statement containing the same information as the Form 1098-E filed with the Service must be furnished to the payor by January 31, 2000. Similarly, Notice 98–7, as modified by this notice, applies for 1999 with respect to how penalties will be administered under §§ 6721 and 6722 for information returns required under § 6050S.

EFFECT ON OTHER DOCUMENTS

Notice 98–7 is modified.

DRAFTING INFORMATION

The principal author of this notice is John J. McGreevy of the Office of the Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice contact him on (202) 622-4910 (not a toll-free call).

Awards of Costs and Certain Fees in Tax Litigation

Notice 98–55

Section 3101(e) of the Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105–206, amended § 7430 of the Internal Revenue Code to add a "qualified offer rule" that treats certain taxpayers as prevailing parties when the United States has rejected their offer to settle their tax controversy. Treatment as a prevailing party is a necessary element for a taxpayer to receive an award of reasonable administrative and litigation costs in connection with an administrative or court proceeding. The Service and the Treasury Department intend to publish guidance to address several issues raised by the new qualified offer rule and invite public comment on these issues.

BACKGROUND

Under § 7430, as amended, a taxpayer qualifying as a prevailing party under this new qualified offer rule may be eligible to receive an award for reasonable administrative and litigation costs in connection with an administrative or court proceeding, even when the position of the United States is reasonable and even though the taxpayer does not substantially prevail in the tax controversy. To qualify as a prevailing party under this new rule, a taxpayer must meet the net worth requirements and make a "qualified offer" during the "qualified offer period." If the Service rejects the taxpayer's last qualified offer made during the qualified offer period, and the tax liability of the taxpayer (as determined by a court judgment) is less than the tax liability would have been had the last qualified offer been accepted, the taxpayer qualifies as a prevailing party under § 7430. A "qualified offer" is a written offer that is made by the taxpayer to the United States during the qualified offer period, specifies the amount of the taxpayer's tax liability (determined without regard to interest), is designated a qualified offer when made, and remains open until the earliest of: (1) the date the offer is rejected, (2) the date the trial begins, or (3) 90 days from the date of the offer. The "qualified offer period," during which a qualified offer may be made, begins on the date the 30-day letter is mailed by the Service to the taxpayer and ends on the date which is 30 days before the date the case is first set for trial.

ISSUES FOR COMMENT

The Service and Treasury invite public comments on the following issues (and any others) raised by the new qualified offer rule:

Comparison of Liability:

In multiple issue tax cases, partial settlements involving discrete issues often occur throughout both the administrative and court proceedings. Depending upon when a qualified offer is made, issues involved in the proceeding at the time of the offer may not be part of the court's adjudication but may still be part of the judgment entered by the court. If settlement occurs before the court proceeding is commenced, those issues would not be part of the judgment. The Service and Treasury are interested in receiving comments on how the settlement of issues at the various stages of the proceedings should be taken into account in comparing the taxpayer's liability under the judgment with that under the qualified offer.

(1) In comparing a taxpayer's tax liability under a qualified offer with the taxpayer's tax liability under a court judgment, should the comparison be limited to court-determined issues or should settled issues also be taken into account?

(2) If settled issues are included in the comparison, should issues settled before the court proceeding is commenced be included in the comparison?

Content of Offer:

If it is determined that settled issues are not to be taken into account, in whole or in part, a meaningful comparison will only be possible if the qualified offer is specific enough to carve out those issues from the comparison. On the other hand, if all settled issues are to be included in the comparison, a lump-sum offer could be compared with the liability under the judgment as modified to take into account the settled issues not included in the judgment. The Service and Treasury are interested in receiving comments on how the qualified offer rule should be applied in such multiple issue cases.

(1) May a qualified offer be in the form of a lump-sum amount when the case involves multiple tax issues (one or more of which may be settled while others may be determined by the court)?

(2) How much specificity should a qualified offer be required to contain when the case involves multiple tax issues (one or more of which may be settled while others may be determined by the court)?

Timing of Offer:

In the U.S. Tax Court, the court places cases on a trial calendar that lists the cases to be heard by the court during the designated trial session. Notices informing the parties that their respective cases are set for trial during the designated trial session are usually sent by the court five or six months prior to the beginning of the trial session. Not infrequently, cases are continued, stricken or otherwise removed from the calendar on which they were originally set for trial and placed on another trial calendar relating to a different trial session. At the start of each trial session, all cases appearing on the trial calendar that have not been previously disposed of will be called by the court. Thereafter, the court announces the dates and times that the cases will be tried during the trial session. Thus, the actual trial date is often unknown until after the calendar call. Depending on how the phrase "first set for trial" is interpreted with respect to a Tax Court case, the length of the period during which a qualified offer may be made may vary significantly. The Service and Treasury are interested in receiving comments on whether the settlement process is better promoted by interpreting the phrase "first set for trial" to provide a longer qualified offer period or by interpreting that phrase to provide a shorter qualified offer period.

(1) When should a U.S. Tax Court case be considered "first set for trial": (a) on the date of the calendar call for the first trial session during which the case is originally set for trial; (b) on the date the case is actually called for trial; or (c) on some other date?

(2) When should a U.S. district court, U.S. bankruptcy court, or Court of Federal Claims case be considered "first set for trial"?

(3) What effect, if any, should a continuance have on when a case is considered "first set for trial"?

ADDRESS FOR COMMENTS

Written comments on the new qualified offer rule issues should be submitted by November 30, 1998, should reference Notice 98-55, and may be submitted by mail to:

Internal Revenue Service
Attn: CC:DOM:CORP:T:R
(DOM:FS:IT&A) Room 5226
P.O. Box 7604
Ben Franklin Station
Washington, DC 20044

or may be hand-delivered between the hours of 8 a.m. and 5 p.m. to CC:DOM:CORP:R (DOM:FS:IT&A) at the Courier's Desk, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Alternatively, comments may be submitted electronically via: http://www.irs.ustreas.gov/prod/tax_regs/comments.html (the Service's Internet site).

DRAFTING INFORMATION

The principal authors of this notice are Tom Moffitt and Henry Schneiderman of the Office of the Assistant Chief Counsel (Field Service). For further information regarding this notice, please contact Mr. Moffitt at (202) 622-7900 or Mr. Schneiderman at (202) 622-7820 (not toll-free calls).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, §§ 1361, 1362; 1.1361–1, 1.1362–4, 1.1362–6, 301.9100–1, 301.9100–3.)

Rev. Proc. 98–55

SECTION 1. PURPOSE

This revenue procedure amplifies and supersedes the provisions of Rev. Proc. 94–23, 1994–1 C.B. 609, and Rev. Proc. 97–40, 1997–33 I.R.B. 50. This revenue procedure is intended to provide guidance for taxpayers requesting relief for late S corporation elections and certain untimely elections required to be filed by or with respect to an S corporation. Accompanying this document is a flowchart designed to aid taxpayers in applying this revenue procedure.

SECTION 2. BACKGROUND

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation," with respect to any taxable year, as a small business corporation for which an S corporation election is in effect for that year.

Section 1361(b)(1) defines a "small business corporation" as a domestic corporation that is not an ineligible corporation and that does not (A) have more than 75 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1362(a)(1) provides that, except in a situation described in § 1362(g), a small business corporation may elect to be treated as an S corporation.

Section 1362(b)(1) provides that the corporation may make an election to be treated as an S corporation (A) at any time during the preceding taxable year, or (B) at any time during the taxable year and on or before the 15th day of the 3rd month of the taxable year. Under § 1362(b)(3), if an S corporation election is made for a taxable year after the 15th day of the 3rd month of that taxable year and on or before the 15th day of the 3rd month of the following taxable year, then the S corporation election is treated as made for the following taxable year.

Section 1362(b)(5) provides that if (A) an election under § 1362(a) is made for any taxable year (determined without regard to § 1362(b)(3)) after the date prescribed by § 1362(b) for making the election for the taxable year or no election is made for any taxable year, and (B) the Secretary determines that there was reasonable cause for the failure to timely make the election, the Secretary may treat the election as timely made for the taxable year (and § 1362(b)(3) shall not apply).

Rev. Proc. 97–40 provides a special procedure to request relief for a late S corporation election. That revenue procedure applies only to a corporation (1) that has not filed a timely S corporation election under § 1362(a)(1), (2) for which an S corporation election is filed within 6 months of the original due date for the election, and (3) for which the due date of the tax return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed.

Rev. Proc. 97–48, 1997–43 I.R.B. 19, provides special procedures to obtain automatic relief for certain late S corporation elections in two situations. In both situations, relief is available only where the due date for the tax return for the first year the corporation intended to be an S corporation has passed and other eligibility requirements are met. Rev. Proc. 97–48 does not provide relief for late electing small business trust (ESBT), qualified subchapter S trust (QSST), or qualified subchapter S subsidiary (QSub) elections.

Section 1362(f) grants the Service authority to provide relief in situations where a corporation's S election was not effective for the taxable year for which it was made by reason of a failure to meet the requirements of § 1361(b), or where the corporation's S election terminates under § 1362(d)(2) or (3). A corporation is eligible for relief under this provision if (1) the Secretary determines that the circumstances resulting in the ineffectiveness or termination were inadvertent, (2) no later than a reasonable period of time after discovery of the circumstances resulting in the ineffectiveness or termination, steps were taken so that the S corporation is a small business corporation, and (3) the corporation, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make any adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to the period. If a corporation is eligible for relief under this provision, then, notwithstanding the circumstances resulting in the ineffectiveness or termination, the corporation will be treated as an S corporation during the period specified by the Secretary.

Section 1.1362–4 of the Income Tax Regulations sets forth additional guidance regarding inadvertent termination relief. Section 1.1362–4(b) provides that the corporation has the burden of establishing that under the relevant facts and circumstances the Commissioner should determine that the termination was inadvertent. The fact that the terminating event was not reasonably within the control of the corporation and was not part of a plan to terminate the election, or the fact that the event took place without the knowledge of the corporation, notwithstanding its due diligence to safeguard against such an event, tends to establish that the termination was inadvertent. Section 1.1362–4(c) provides that a taxpayer may request inadvertent termination relief by submitting a request for a private letter ruling. Section 1.1362–4(d) provides that the Commissioner may condition the granting of a ruling request on any adjustments that are appropriate. Section 1.1362–4(e) requires the corporation and all persons who were shareholders of the corporation at any time during the time specified by the Commissioner to consent to any adjustments that the Commissioner may require.

Section 1361(d)(1)(A) provides that in the case of a QSST with respect to which a beneficiary makes an election under § 1361(d)(2), the trust will be treated as a trust described in § 1361(c)(2)(A)(i) (relating to trusts that may be a shareholder of a small business corporation under § 1361(b)(1)). Pursuant to § 1361(d)(2)(A) and § 1.1361–1(j)(6)(i), the election by a current income beneficiary of a QSST may be made by the beneficiary's legal representative (or a natural or an adoptive parent of the current income beneficiary if a legal representative has not been appointed and the current income beneficiary is a minor).

Section 1361(d)(2) provides for the time and manner in which the beneficiary of a QSST may elect to have the provisions of § 1361(d) apply. Included is the requirement that the QSST election must be filed within the 2 month and 16 day period beginning on the day that the stock is transferred to the trust.

Section 1361(d)(3) sets forth the provisions a trust instrument must contain for the trust to qualify as a QSST. Under § 1361(d)(3)(A), the terms of the trust must require that: (i) during the life of the current income beneficiary, there is only one income beneficiary; (ii) any corpus distributed during the life of the current beneficiary may be distributed only to that beneficiary; (iii) the current income beneficiary's interest terminates on the earlier of the beneficiary's death or the trust's termination; and (iv) if the trust terminates during the current income beneficiary's life, the trust assets must be distributed to that beneficiary. In addition, § 1361(d)(3)(B) requires that the trust must distribute all of its income (within the meaning of § 643(b)) currently to one individual who is a United States resident or citizen.

Rev. Proc. 94–23 provides automatic inadvertent termination relief to certain corporations whose S corporation election terminates because stock of the corporation was transferred to a trust whose current income beneficiary (or the legal representative of the current income beneficiary) inadvertently failed to file a timely election with respect to a QSST under § 1361(d)(2). Section 4 of that revenue procedure provides the prerequisites for automatic relief and the procedural requirements for obtaining it.

Section 1361(c)(2)(A)(v) provides that an ESBT (as defined in § 1361(e)) is a permitted S corporation shareholder. Generally, an ESBT is any trust if: (1) the trust does not have as a beneficiary any person other than an individual, an estate, or an organization described in § 170(c)(2), (3), (4), or (5); (2) no interest in the trust was acquired by purchase; and (3) an election to be an ESBT has been filed with respect to the trust.

Section 1361(b)(3)(B) provides that a QSub is a domestic corporation that is not an ineligible corporation, if (1) an S corporation holds 100 percent of the stock of the corporation, and (2) that S corporation elects to treat the subsidiary as a QSub.

Under § 301.9100–1(c) of the Procedure and Administration Regulations, the Commissioner may grant a reasonable extension of time to make a regulatory election or certain statutory elections under all subtitles of the Code, except subtitles E, G, H, and I, if the taxpayer demonstrates to the satisfaction of the Commissioner that the taxpayer acted reasonably and in good faith, and that granting the relief will not prejudice the interests of the Government. Section 301.9100–1(b) defines the term "regulatory election" as an election whose due date is prescribed by a regulation published in the Federal Register, or a revenue ruling, revenue procedure, notice, or announcement published in the Internal Revenue Bulletin.

SECTION 3. SCOPE

.01 *In General.* This revenue procedure extends the special procedure for late S corporation elections described in Rev. Proc. 97–40 from 6 months to 12 months (but in no event later than the unextended due date of the tax return for the first year the corporation intended to be an S corporation), provides similar relief for certain QSub elections, and extends the application of Rev. Proc. 94–23 to ESBT elections.

.02 *Late S Corporation Elections.* With respect to late S corporation election s, this revenue procedure applies only to a corporation (1) that has not filed a timely S corporation election under § 1362(a)(1), (2) for which an S corporation election is filed within 12 months of the original due date for the election, and (3) for which the due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed. Section 4 of this revenue procedure describes a simplified method for obtaining relief where the corporation can demonstrate reasonable cause for the failure to file a timely S corporation election. Section 4 also provides automatic relief for ESBT, QSST, and QSub elections intended to be effective as of the first date the corporation intended to elect S corporation status for itself.

.03 *Untimely QSub Elections.* This revenue procedure also applies to certain QSub elections for which the automatic relief described above is not available because the parent corporation's S election was timely filed. For those situations, this revenue procedure applies only to a corporation (1) for which a timely QSub election under § 1361(b)(3)(B) was not filed for the desired effective date, (2) for which a QSub election is filed within 12 months of the date that an election for the desired effective date should have been filed, and (3) for which the due date for the S corporation's tax return (excluding extensions) for the first taxable year for which the S corporation desired QSub status for the subsidiary has not passed. Section 5 of this revenue procedure describes a simplified method, similar to that for a late S corporation election, for filing an untimely QSub election.

.04 *Late ESBT and QSST Elections.* For late ESBT or QSST elections, this revenue procedure applies to corporations that, but for (1) a trust beneficiary's inadvertent failure to make a timely QSST election or (2) a trustee's inadvertent failure to make a timely ESBT election, would otherwise meet or continue to meet the criteria for S corporation status. Section 6.02 of this revenue procedure provides an automatic grant of relief for certain corporations that satisfy the criteria therein.

.05 *Alternate Relief.* This revenue procedure provides alternatives to the letter ruling process ordinarily used to obtain relief for late S corporation and related elections under § 1362(b)(5), § 1362(f), or §§ 301.9100–1 and 301.9100–3. Accordingly, user fees do not apply to corrective action under this revenue procedure. However, a corporation or trust that does not meet the requirements for relief or is denied relief under this revenue procedure may request inadvertent termination, inadvertent invalid election, or late election relief (as appropriate) by requesting a private letter ruling. The Service will not ordinarily issue a private letter ruling if the period of limitations on assessment under § 6501(a) has lapsed for any taxable year for which an election should have been made or any taxable year that would have been affected by the election had it been timely made. The procedural requirements for requesting a private letter ruling are described in Rev. Proc. 98–1, 1998–1 I.R.B. 7 (or its successor).

SECTION 4. RELIEF FOR LATE S CORPORATION ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 *Relief When Late S Election is Sole Defect.*

(1) *Eligibility for Relief.* A corporation is eligible for relief under section 4.03 of this revenue procedure if the following requirements are met:

(a) The corporation fails to qualify as an S corporation on the first day that S corporation status was desired solely because the Form 2553 (Election by a Small Business Corporation) was not filed timely pursuant to § 1362(b)(1),

(b) The due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation has not passed, and

(c) The corporation has reasonable cause for its failure to timely make the S corporation election.

(2) *Procedural Requirements for Relief.* Within 12 months of the original due date for the S corporation election (but in no event later than the due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation), the corporation must file with the applicable service center a completed Form 2553, signed by an officer of the corporation authorized to sign and all persons who were shareholders at any time during the period that began on the first day of the taxable year for which the election is to be effective and ends on the day the election is made. For purposes of signing the shareholder consent, any trust that qualifies for relief under section 6 of this revenue procedure, but did not hold stock on the first day the corporation intended S corporation status, is considered an eligible shareholder. In this situation, the corporation must also file a request for relief pursuant to section 6 of this revenue procedure and attach it to the Form 2553. The Form 2553 must state at the top of the document "FILED PURSUANT TO REV. PROC. 98–55." Attached to the Form 2553 must be a statement explaining the reason for the failure to file a timely S corporation election.

.02 *Relief for Late S Election and Automatic Relief for Invalid Elections and Late Elections.*

(1) *Eligibility for Relief.*

(a) *Late S Election and Late ESBT or QSST Election.* A corporation is eligible for relief under section 4.03 of this revenue procedure, and the trustee of a trust that would otherwise qualify as an ESBT or the beneficiary of a QSST is eligible to make an ESBT or QSST election, respectively, effective on the first day of the relevant corporation's first taxable year as an S corporation under section 4.04 of this revenue procedure, if the following requirements are met:

(i) The corporation fails to qualify as an S corporation because the Form 2553 was not filed timely pursuant to § 1362(b)(1);

(ii) The trust fails to qualify as an ESBT or to be taxable as described in § 1361(d)(1)(B) (relating to a QSST and its current income beneficiary) on the first day of the related corporation's first taxable year as an S corporation solely because a proper ESBT or QSST election, whichever is applicable, was not filed timely;

(iii) The due date for the tax return of the corporation (excluding extensions) for the first taxable year the corporation intended to be an S corporation has not passed; and

(iv) The corporation has reasonable cause for its failure to timely make the S corporation election.

(b) *Late S Election and Untimely QSub Election.* A parent corporation is eligible for relief under section 4.03 of this revenue procedure, and may make a QSub election with respect to a subsidiary effective on the first day of the parent corporation's first taxable year as an S corporation under section 4.04 of this revenue procedure, if the following requirements are met:

(i) The parent corporation fails to qualify as an S corporation because the Form 2553 was not filed timely pursuant to § 1362(b)(1);

(ii) The subsidiary corporation fails to qualify as a QSub on the first day of the parent corporation's first taxable year as an S corporation solely because a proper QSub election was not filed timely (after giving effect to the relief provided in section 4.03 of this revenue procedure);

(iii) The due date for the parent S corporation's tax return (excluding extensions) for the first taxable year the parent corporation intended to be an S corporation has not passed; and

(iv) The parent corporation has reasonable cause for its failure to timely make the S corporation election.

(2) *Procedural Requirements for Relief.* Within 12 months of the original due date for the S corporation election (but in no event later than the due date for the tax return (excluding extensions) for the first year the corporation intended to be an S corporation), the corporation must file with the applicable service center a completed Form 2553, signed by an officer of the corporation authorized to sign and all persons who were shareholders at any time during the period that began on the first day of the taxable year for which the election is to be effective and ends on the day the election is made. Accompanying the Form 2553 must be all applicable ESBT, QSST, or QSub elections, completed in accordance with the proper procedure for the election as provided in regulation, revenue procedure, or notice. All of the above elections must state at the top of the document "FILED PURSUANT TO REV. PROC. 98–55." Attached to the Form 2553 must be a statement explaining the reason for the failure to file a timely S corporation election.

.03 *Relief for Late S Corporation Election.* Upon receipt of a completed application requesting relief under section 4.01 or 4.02 of this revenue procedure, the Service will determine whether the requirements for granting an additional time to file an S corporation election have been satisfied and will notify the corporation of the result of this determination.

.04 *Automatic Relief for Late ESBT, QSST, and QSub Elections.* If relief for a late S corporation election is granted pursuant to section 4.03 of this revenue procedure, any request for relief submitted pursuant to the terms of section 4.02 of this revenue procedure will be automatically approved by the Service.

.05 *Automatic Relief for Late S Corporation Elections Provided in Other Documents.* Certain corporations may be eligible for automatic late S corporation election relief pursuant to Rev. Proc. 97–48.

SECTION 5. RELIEF FOR CERTAIN QSUB ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Relief.* A corporation that is not requesting relief under section 4 of this revenue procedure (because the corporation has a valid S corporation election) may be granted additional time under section 5.03 of this revenue procedure to file a QSub election with respect to a subsidiary if the following requirements are met:

(1) The subsidiary corporation fails to qualify as a QSub on the desired effective date solely because the parent S corporation failed to file a timely (with respect to the desired effective date) election to treat the subsidiary as a QSub;

(2) The due date for the S corporation's tax return (excluding extensions) for the first taxable year of the S corporation for which it intended to treat the subsidiary as a QSub has not passed; and

(3) The S corporation has reasonable cause for its failure to timely make the QSub election.

.02 *Procedural Requirements for Relief.* Within 12 months of the due date for filing a QSub election to be effective on the desired effective date (but in no event later than the due date for the S corporation's tax return (excluding extensions) for the first taxable year of the S corporation for which the S corporation intended to treat the subsidiary as a QSub), the corporation must file with the applicable service center a completed QSub election. The QSub election must state at the top of the form "FILED PURSUANT TO REV. PROC. 98–55." Attached to the form must be a statement explaining the reason for the failure to file a QSub election within the time period required for the desired effective date. For purposes of this section 5, if a corporation is seeking (or has sought) relief under section 4.01 of this revenue procedure for a late S corporation election, and also did not make a timely (with respect to the desired effective date) election to treat a subsidiary as a QSub effective on a date other than the first day the corporation intended to be an S corporation, the corporation will be treated as having made a valid S corporation election. In this situation, the corporation must also file (or have filed) a request for relief pursuant to section 4.01 of this revenue procedure.

.03 *Grant of Additional Time for Filing Certain QSub Elections.* Upon receipt of a completed application requesting relief under section 5.02 of this revenue procedure, the Service will determine whether the requirements for granting an additional time to file a QSub election have been satisfied and will notify the corporation of the result of this determination.

SECTION 6. RELIEF FOR CERTAIN LATE ESBT AND QSST ELECTIONS UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Automatic Relief.* A corporation is eligible for inadvertent invalid election relief or inadvertent termination relief under section 6.03 of this revenue procedure if it meets the following requirements:

(1) The corporation's S corporation election was invalid or terminated solely because the beneficiary of a QSST (or the beneficiary's legal representative) failed to file a timely QSST election pursuant to § 1361(d)(2) or the trustee of a trust that would otherwise qualify as an ESBT failed to file a timely ESBT election pursuant to § 1361(e)(3);

(2) All taxpayers whose tax liability and tax returns would be affected by the QSST or ESBT election (including the trust itself and, in the case of a QSST, the beneficiary of the trust) have reported their income (on all affected returns) consistent with the corporation's S corporation election for the year the QSST or ESBT election should have been made, as well as for any subsequent year;

(3) The failure to file a timely QSST or ESBT election was inadvertent; and

(4) Within 24 months of the original due date of the election, the beneficiary of the QSST or the trustee of the ESBT files the election pursuant to this revenue procedure.

.02 *Procedural Requirements for Automatic Relief.*

The current income beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT) of the trust must sign and file the appropriate election with the applicable service center. This election must state at the top "FILED PURSUANT TO REV. PROC. 98–55" and include the following material:

(1) The names, addresses, and taxpayer identification numbers of the current income beneficiary (in the case of a QSST), the trust, and the corporation;

(2) A statement identifying the election as an election under § 1361(d)(2) or § 1361(e)(3);

(3) The date on which the stock of the corporation was originally transferred to the trust;

(4) In the case of a QSST, an affidavit from the trustee stating that the trust satisfies the QSST requirements of § 1361(d)(3) and that the income distribution requirements have been and will continue to be met;

(5) In the case of an ESBT, an affidavit from the trustee stating that all potential current beneficiaries meet the shareholder requirements of § 1361(b)(1) and that the trust satisfies the requirements of an ESBT under § 1361(e)(1) other than the requirement to make an ESBT election;

(6) An affidavit from the current income beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT) stating that the failure to file the relevant election was inadvertent and that the beneficiary or trustee acted diligently to correct the mistake upon its discovery;

(7) Affidavits from all shareholders during the period between the date the S corporation election terminated or was to have become effective and the date the completed election was filed (including the trust itself and, in the case of a QSST, the beneficiary of the trust) stating that they have reported their income (on all affected returns) consistent with the S corporation election for the year the election should have been made and for any subsequent year; and

(8) A dated declaration, signed by the current income beneficiary (in the case of a QSST) or the trustee (in the case of an ESBT), which states: "Under penalties of perjury, I declare that, to the best of my knowledge and belief, the facts presented in support of this election are true, correct, and complete."

.03 *Automatic Relief for Late ESBT and QSST Elections.* Corporations that satisfy the requirements of sections 6.01 and 6.02 of this revenue procedure will automatically be granted relief pursuant to the provisions of § 1362(f). Thus, the corporation will be treated as an S corporation for the period beginning on the date of termination or the date on which the election was to have become effective, whichever applies, and ending on the date the completed ESBT or QSST election is filed, and thereafter, unless the S corporation election is otherwise terminated under § 1362(d). In addition, during such period, the trust will be treated as a trust described in § 1361(c)(2)(A), and the rules applicable to ESBTs or QSSTs will apply. In the case of a QSST, the beneficiary of the trust will be treated, for purposes of § 678, as the owner of that portion of the trust consisting of S corporation stock.

SECTION 7. DEEMED SHAREHOLDERS

Any reference in this revenue procedure to a shareholder of an S corporation shall be treated as including a reference to those persons whose consent is required under § 1.1362–6(b).

SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 94–23 and Rev. Proc. 97–40 are amplified and superseded.

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for all applications (including those applications now being considered by the Service) for relief satisfying the requirements of sections 4, 5, or 6 of this revenue procedure (including those filed pursuant to either Rev. Proc. 94–23 or Rev. Proc. 97–40).

SECTION 10. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1548.

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

The collections of information in this revenue procedure are in sections 4.01(2), 4.02(2), 5.02, and 6.02. This information is required to be submitted to the applicable service center in order to obtain relief for late or inadvertently invalid S corporation elections, as well as other late elections. This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 500 hours.

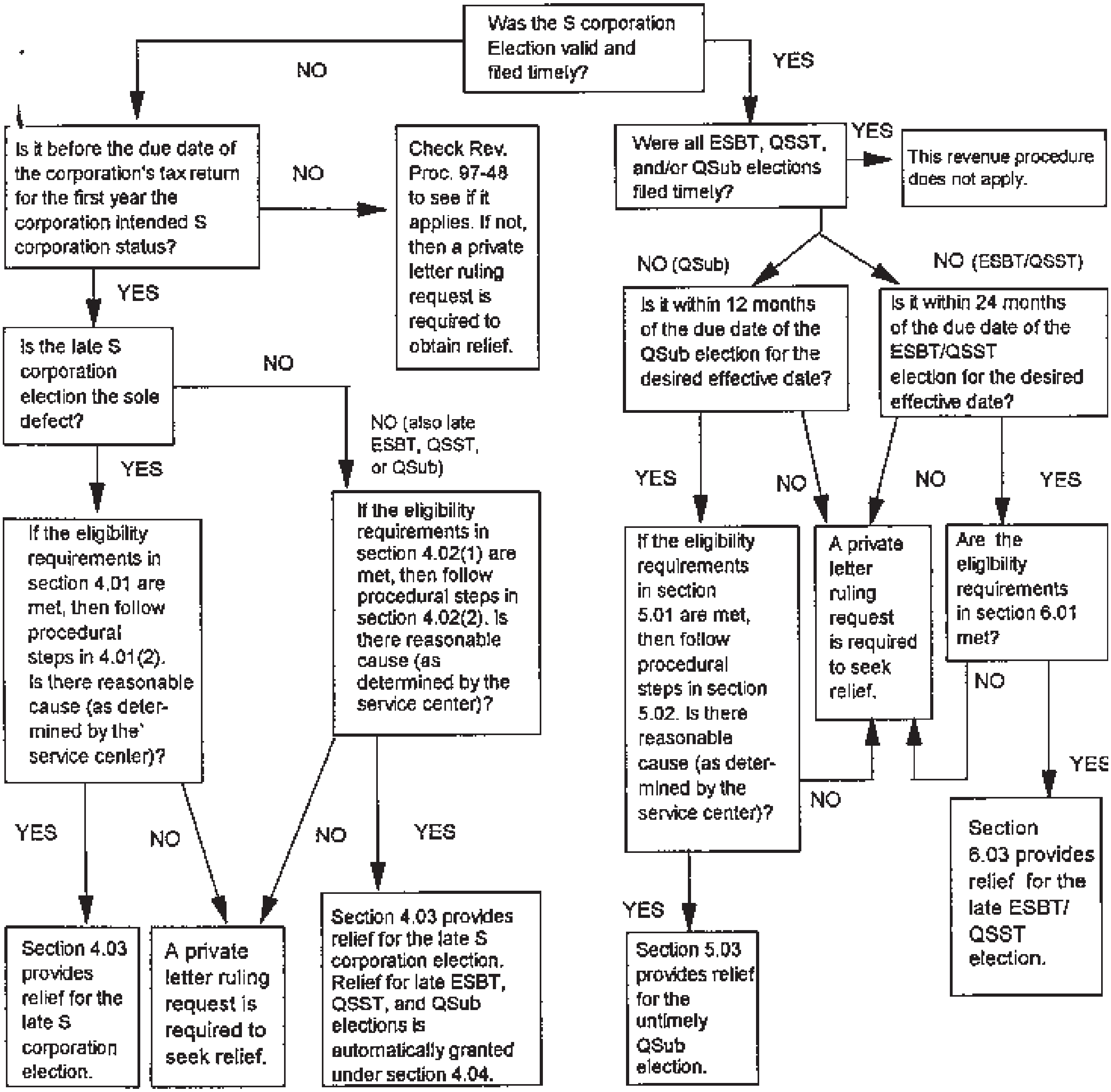
The estimated annual burden per respondent varies from .5 hours to 7 hours, depending on individual circumstances, with an estimated average burden of 1 hour to complete the statement. The estimated number of respondents is 500.

The estimated annual frequency of responses is on occasion.

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.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Mark D. Harris and Deanna L. Walton of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure contact Ms. Walton at (202) 622-3050 (not a toll-free call).


Was the S corporation Election valid and filed timely?
NO
YES
Is it before the due date of the corporation's tax return for the first year the corporation intended S corporation status?
NO
Check Rev. Proc. 97-48 to see if it applies. If not, then a private letter ruling request is required to obtain relief.
YES
Is the late S corporation election the sole defect?
NO
YES
NO (also late ESBT, QSST, or QSub)
If the eligibility requirements in section 4.01 are met, then follow procedural steps in 4.01(2). Is there reasonable cause (as determined by the service center)?
If the eligibility requirements in section 4.02(1) are met, then follow procedural steps in section 4.02(2). Is there reasonable cause (as determined by the service center)?
YES
NO
NO
YES
Section 4.03 provides relief for the late S corporation election.
A private letter ruling request is required to seek relief.
Section 4.03 provides relief for the late S corporation election. Relief for late ESBT, QSST, and QSub elections is automatically granted under section 4.04.
Were all ESBT, QSST, and/or QSub elections filed timely?
YES
This revenue procedure does not apply.
NO (QSub)
NO (ESBT/QSST)
Is it within 12 months of the due date of the QSub election for the desired effective date?
Is it within 24 months of the due date of the ESBT/QSST election for the desired effective date?
YES
NO
NO
YES
If the eligibility requirements in section 5.01 are met, then follow procedural steps in section 5.02. Is there reasonable cause (as determined by the service center)?
A private letter ruling request is required to seek relief.
Are the eligibility requirements in section 6.01 met?
NO
NO
YES
YES
Section 5.03 provides relief for the untimely QSub election.
Section 6.03 provides relief for the late ESBT/QSST election.

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 98–56

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 98–3, 1998–1 I.R.B. 100, which sets forth areas of the Internal Revenue Code (Code) under the jurisdiction of the Associate Chief Counsel (Domestic) and the Associate Chief Counsel (Employee Benefits and Exempt Organizations) in which the Internal Revenue Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 5 of Rev. Proc. 98–3 sets forth those areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, or otherwise. Section 631(a) of the Code provides that a taxpayer may elect to treat the cutting of certain timber as a sale or exchange of that timber. Sections 631(b) and (c) treat the specified gain or loss on the disposal of certain timber, coal, or domestic iron ore under a contract whereby the owner retains an economic interest in the property as though it were a gain or loss on the sale of such property. Section 1374 imposes a tax on the recognized built-in gains of an S corporation. The Service intends to study further whether § 1374 applies to the situations described in section 3 of this revenue procedure.

SECTION 3. PROCEDURE

Rev. Proc. 98–3 is amplified by adding to section 5 the following:
Section 1374.—Tax Imposed on Certain Built-in Gains—The tax consequences under § 1374 in the following situations: (1) an S corporation holds timber property on the date it converts from a C corporation to an S corporation (or acquires timber property from a C corporation in a transaction to which § 1374(d)(8) applies) and during the recognition period (a) cuts the timber and sells resulting wood products (including any unfinished or finished products derived, manufactured, or produced from such wood products) in a transaction to which § 631 does not apply, (b) recognizes gain or loss on cutting the timber pursuant to a § 631(a) election, or (c) recognizes gain or loss on the disposal of timber under a contract to which § 631(b) applies, and (2) an S corporation holds coal or domestic iron ore property on the date it converts from a C corporation to an S corporation (or acquires coal or domestic iron ore property from a C corporation in a transaction to which § 1374(d)(8) applies) and during the recognition period recognizes gain or loss on the disposal of the coal or iron ore under a contract to which § 631(c) applies.

SECTION 4. EFFECTIVE DATE

This revenue procedure applies to all ruling requests, including any pending in, or received by, the National Office on or after October 30, 1998 (the date it is released to the public).

SECTION 5. REQUEST FOR PUBLIC COMMENTS

The Service requests comments on the extent to which § 1374 applies to the situations described in section 3 of this revenue procedure. Written comments must be received by January 28, 1999. Send comments to: CC:DOM:CORP:R (Revenue Procedure 98–56), 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 5 p.m. to CC:DOM:CORP:R (Revenue Procedure 98-56), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Service's Internet site at www.irs.ustreas.gov/prod/tax_regs/comments.html. All comments submitted will be available for public inspection and copying.

DRAFTING INFORMATION

The principal author of this revenue procedure is Marlene P. Oppenheim of the Office of the Assistant Chief Counsel (Corporate). For further information regarding this revenue procedure contact Ms. Oppenheim at (202) 622-7750 (not a toll-free call).

Part IV. Items of General Interest

Test of Mediation Procedure for Appeals

Announcement 98–99

SUMMARY: The Service has tested the use of mediation for Coordinated Examination Program (CEP) cases assigned to Appeals Team Chiefs. The Service is now expanding the mediation test to allow taxpayers to request mediation for factual issues involving an adjustment of $1 million or more that are already in the Appeals administrative process. Under the mediation procedure the taxpayer and Appeals will continue to negotiate a settlement, but an objective and neutral third party mediator will assist them. The mediator has no authority to impose a decision; decision-making authority remains with the taxpayer and Appeals. This procedure is effective for requests for mediation made during the two-year test period beginning on November 16, 1998, the date this Announcement is published in the Internal Revenue Bulletin. Additionally, section 3465 of the Internal Revenue Service Restructuring and Reform Act of 1998, P.L. 105–206 (the Act), provides for expansion of mediation below the $1 million threshold contained in this procedure. Because Appeals intends to expand the availability of mediation as required by the Act, Appeals welcomes comments on the process. Comments should be submitted by February 14, 1999, either to:

National Director of Appeals
901 D Street, SW
Box 68
Washington, D.C. 20024
Attn: C:AP:ADR & CS, Room 236

or electronically via: http://www.irs.ustreas.gov/prod/tax_regs/comments.html (the Service Internet site).

BACKGROUND: Announcement 95–86, 1995–44 I.R.B. 27, and Announcement 97–1, 1997-2 I.R.B. 62, contain the procedure that taxpayers previously used to request mediation. Under these Announcements, mediation only applied to certain issues in CEP cases assigned to Appeals Team Chiefs. A test of the mediation procedure concluded on January 12, 1998.

CHANGES: The mediation procedure has been expanded to allow for additional cases to be eligible for mediation. Mediation is no longer limited to CEP cases assigned to Appeals Team Chiefs; it is now available for factual issues (such as valuation, reasonable compensation and transfer pricing) involving an adjustment of $1 million or more, arising from examination.

FOR FURTHER INFORMATION CONTACT: Thomas Carter Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs, National Office Appeals, (202) 401-4098 (not a toll-free number).

TEST OF MEDIATION PROCEDURE FOR APPEALS

Summary:

Appeals is conducting an additional two-year test of its mediation procedure. This test will allow taxpayers to request mediation for factual issues involving an adjustment of $1 million or more that are already in the Appeals administrative process. Under the procedure, the taxpayer and Appeals will attempt to negotiate a settlement, assisted by an objective and neutral third party who has no authority to impose a decision. This procedure is effective for requests for mediation made during the additional two-year test period beginning on November 16, 1998, the date this Announcement is published in the Internal Revenue Bulletin.

Overview:

The mission of Appeals is to resolve tax controversies, without litigation, on a basis which is fair and impartial to both the Government and the taxpayer. Mediation is an extension of the Appeals process and will enhance voluntary compliance. Mediation is a nonbinding process, and the mediator will help the parties reach their own negotiated settlement. To accomplish this goal, the mediator will act as a facilitator, assist in defining the issues, and promote settlement negotiations between the parties. The mediator will not have settlement authority in the mediation process and will not render a decision regarding any issue in dispute. The mediator should inform and discuss with the parties the rules and procedures concerning the mediation process.

Scope of Mediation:

The mediation procedure will attempt to resolve factual issues while a case is in the jurisdiction of Appeals. This procedure may be used only after Appeals settlement discussions are unsuccessful, and when all other issues are resolved but for the issue(s) for which mediation is being requested. Mediation is available for:

- Factual issues (such as valuation, reasonable compensation and transfer pricing) involving an adjustment of $1 million or more, arising from examination.

Mediation will not be available for:

- An issue designated for litigation or docketed in any court; [for the Chief Counsel mediation program involving issues in docketed cases, see Chief Counsel Directives Manual (CCDM) (35)3(20)0]
- An Industry Specialization Program (ISP) issue or an Appeals Coordinated Issue (ACI) [ISP issues are listed in Exhibit 8.7.1-1 and ACI issues are listed in section 8.7.1-3 of the Internal Revenue Manual]; or
- An issue for which the taxpayer has filed a request for competent authority assistance, or an issue for which the taxpayer intends to seek competent authority assistance. Mediation is also not available for an issue for which the taxpayer has requested the simultaneous Appeals/Competent Authority procedure described in section 8 of Revenue Procedure 96–13, 1996–1 C.B. 616. If a taxpayer enters into a settlement with Appeals (including an Appeals settlement through the mediation process), and then requests competent authority assistance, the U.S. competent authority will endeavor only to obtain a correlative adjustment with the treaty country and will not take any actions that would otherwise amend the settlement. See section 7.05 of Revenue Procedure 96–13.

Mediation process:

1. Mediation is optional. A taxpayer and an Appeals Team Chief (or Appeals Officer) may request mediation, after consultation with each other. Such request is initiated by the taxpayer sending a written request seeking approval for mediation to the appropriate ARDA-LC, with a copy to the National Director of Appeals. For cases assigned to an Appeals Officer, the handling of such request will be expedited if the taxpayer also sends a copy of the mediation request to the Appeals Officer and the appropriate Appeals Associate Chief.

Request approved—If the ARDA-LC approves the request, the ARDA-LC will inform the taxpayer and the Appeals Team Chief or Appeals Associate Chief and Appeals Officer and schedule a conference to discuss the proposed mediation process.

Request denied—If the ARDA-LC denies the request, the ARDA-LC will promptly inform the taxpayer and the Appeals Team Chief or the Appeals Associate Chief and Appeals Officer. Although no formal appeal procedure exists for the denial of a mediation request, a taxpayer may request a conference with the ARDA-LC to discuss the denial.

Generally, the ARDA-LC will respond to the taxpayer and the Appeals Team Chief or Appeals Associate Chief and Appeals Officer within 30 days after the ARDA-LC receives the taxpayer's request for mediation.

2. Agreement to mediate. The taxpayer and Appeals will enter into a written agreement to mediate. The agreement should be as concise as possible. See Exhibit 1, below for a model agreement to mediate. The ARDA-LC (in consultation with the Appeals Team Chief or Appeals Associate Chief and Appeals Officer) will negotiate and sign the agreement to mediate on behalf of Appeals. The following sections describe some considerations that the taxpayer and Appeals should take into account in preparing this agreement.

3. Participants. The parties to the mediation process will be the taxpayer and Appeals. Absent an agreement to the contrary, the parties must have participants attending the mediation with decision-making authority. The mediation agreement will set forth the procedures by which the parties inform the other parties and the mediator of the participants in the mediation and will set forth any limitation on the number, identity or participation by such participants. In general, the parties are encouraged to include, in addition to the required decision-makers, those persons with information and expertise that will be useful to the decision-makers and the mediator. Each party must notify the mediator and the other party, no later than two weeks before the mediation, regarding the participants on their mediation team. See Exhibit 2, below for a model participants list.

4. Selection of mediators, in general. The taxpayer and the ARDA-LC will select a mediator. The test of mediation procedure for Appeals seeks to include cases using both non-IRS and Appeals personnel as mediators. Appeals' decision to mediate may depend upon the taxpayer's acceptance of an Appeals mediator. See sections 5, 6, and 7, below, regarding who can be a mediator. Co-mediators can also be used, and may be suitable for the most complex issues.

The taxpayer and the ARDA-LC can use any local or national organization that provides a roster of neutrals in selecting a mediator. In order to minimize the possibility of a last-minute disqualification of the mediator(s), the taxpayer and the ARDA-LC are encouraged to prepare a list of parties to the transaction and potential participants in the mediation other than employees of the taxpayer and Appeals for presentation to the potential mediators. If the taxpayer and the ARDA-LC cannot agree on a mediator, they may agree to a procedure to be used to select a mediator.

In obtaining the services of a mediator, the IRS will follow all applicable provisions of the Federal Acquisition Regulation. A mediator shall have no official, financial, or personal conflict of interest with respect to the parties, unless such interest is fully disclosed in writing to the taxpayer and the ARDA-LC and they agree that the mediator may serve. See 5 U.S.C. § 573.

5. Appeals personnel as mediators, conflict statement and expenses. The taxpayer and the ARDA-LC may select an Appeals representative to be the mediator. The Appeals mediator shall be from another Appeals region, or from National Office Appeals. The ARDA-LC from the region in which the case is located will coordinate with the ARDA-LC from the region in which the proposed mediator is located.

Due to the inherent conflict that results because the Appeals mediator is an employee of the IRS, Appeals will provide to the taxpayer a statement confirming the employee's proposed service as a mediator, that the person is a current employee of the IRS and that a conflict results from that mediator's continued status as an IRS employee. The written agreement to mediate will include this statement.

If the parties select an Appeals mediator (or Appeals co-mediator), National Office Appeals will pay the expenses associated with the Appeals mediator (or co-mediator).

6. Non-Internal Revenue Service mediator, expenses. The taxpayer and the ARDA-LC may agree on a mediator from outside the IRS. If the parties select a non-IRS mediator or co-mediator, the taxpayer and National Office Appeals will share expenses associated with the mediator (or co-mediator) equally.

7. Criteria for selection of mediators. Criteria for selecting a mediator or co-mediator may include completion of mediation training, previous mediation experience, a substantive knowledge of tax law, or knowledge of industry practices. Criteria may also include the projected travel costs, hourly fees and other expenses, which will be considered subject to rules and regulations for Government procurement.

8. Issues covered. The agreement to mediate will specify the issue(s) that the parties agree to mediate. Each party will prepare a discussion summary of the issues (including the party's arguments in favor of the party's position) for consideration by the mediator. The discussion summaries should be submitted to the mediator and the other party no later than two weeks before the mediation session is scheduled to begin.

9. Site, date, agenda. The agreement to mediate should identify the location and the proposed date of the mediation session. The parties should attempt to select a site at or near the mediator's office, the taxpayer's office or an Appeals office. The parties should also agree upon an agenda in consultation with the mediator.

10. Confidentiality. The mediation process is confidential. As part of the agreement to mediate, the taxpayer will acknowledge in writing that the mediator, the persons invited to participate in these procedures by the taxpayer, and those persons the IRS invites to participate, may have access to all the taxpayer's return or return information pertaining to the issues being considered, pursuant to I.R.C. § 6103 and the regulations thereunder, particularly I.R.C. §§ 6103(c), and 6103(n) and the regulations thereunder. See Exhibit 3, below for a model consent and acknowledgment form regarding the disclosure of returns and return information. IRS employees involved in any way in the mediation process, the outside mediator and any person under contract to the IRS that the IRS invites to participate will be subject to the confidentiality and disclosure provisions of the Internal Revenue Code, including I.R.C. §§ 6103, 7213, and 7431.

IRS employees, the taxpayer, the outside mediator, and persons invited to participate by the IRS and the taxpayer shall not voluntarily, or through discovery or compulsory process, disclose any information regarding the mediation process or any communication made during the mediation process, including the settlement terms, except as provided in 5 U.S.C. § 574.

11. Section 7214(a)(8) disclosure. Under I.R.C. § 7214(a)(8), IRS employees must report information concerning violations of any revenue law to the Secretary. The agreement to mediate will state this requirement and the parties will acknowledge this duty.

12. Disqualification. The mediator will be disqualified from representing the taxpayer in any pending or future action that involves the transactions or issues that are the particular subject matter of the mediation. This disqualification extends to representing any other parties involved in the transactions or issues that are the particular subject matter of the mediation. Moreover, the mediator's firm will be disqualified from representing the taxpayer or any other parties involved in the transactions or issues that are the particular subject matter of the mediation in any action that involves the transactions or issues that are the particular subject matter of the mediation.

The mediator's firm will not be disqualified from representing the taxpayer or any other parties in any future action that involves the same transactions or issues that are the particular subject matter of the mediation, provided that (I) the mediator disclosed the potential of such representation to the parties to the mediation conducted by the mediator prior to the parties' acceptance of the mediator, (ii) such action relates to a taxable year that is different from the taxable year that is the subject matter of the mediation, (iii) the firm's internal controls preclude the mediator from any form of participation in the matter, and (iv) the firm does not apportion to the mediator any part of the fee therefrom. In the event the mediator has been selected prior to the mediator learning of the identity of one or more of the parties involved in the mediation, requirement (I) will be deemed satisfied if the mediator promptly notifies the parties of the potential representation.

While the mediator may not receive a direct allocation of the fee from the taxpayer (or other party) in the matter for which the internal controls are in effect, the mediator will not be prohibited from receiving a salary, partnership share or corporate distribution established by prior independent agreement. The mediator and his or her firm are not disqualified from representing the taxpayer or any other parties involved in the mediation in any matters unrelated to the transactions or issues that are the particular subject matter of the mediation.

This paragraph 12 only applies to representations on matters before the IRS.

The provisions of this paragraph 12 are in addition to any other applicable disqualification provisions including, for example, the rules of the United States Tax Court and applicable canons of ethics.

13. Withdrawal. Either party may withdraw from the process anytime before reaching a settlement of the issues being mediated by notifying the other party and the mediator in writing.

14. Mediator's report. At the conclusion of the mediation process, the mediator will prepare a brief written report and submit a copy to each party. See Exhibit 4, below for a model mediator's report.

15. Appeals procedures apply. If the parties reach an agreement on all or some issues through the mediation process, Appeals will use established procedures, including preparation of a specific matters closing agreement (Form 906). See Statement of Procedural Rules, 26 C.F.R. § 601.106. Delegation Order 236 (Rev. 3) may apply to settlements resulting from the mediation process.

If the parties do not reach an agreement on an issue being mediated, Appeals will not reconsider it, and a statutory notice of deficiency will be issued.

16. Use as precedent. A settlement reached by the parties through mediation will not be binding on the parties (or otherwise control) for taxable years not covered by the agreement. Except as provided in the agreement, such settlement may not be used as precedent by any party.

17. Effective Date. These procedures are effective for requests for mediation made during the two-year test period beginning on November 16, 1998, the date this Announcement is published in the Internal Revenue Bulletin.

For further information contact: Thomas C. Louthan, Director, Office of Alternative Dispute Resolution and Customer Service Programs, National Office Appeals, (202) 401-4098 (not a toll-free number), or Sandy Cohen, Office of Alternative Dispute Resolution and Customer Service Programs, National Office Appeals, (202) 401-4101 (not a toll-free number).

Exhibit 1:

Model Agreement to Mediate

1. *The Mediation Process.*

The mediation will be an extension of the Appeals process to help [**NAME OF TAXPAYER**] and Internal Revenue Service (IRS)—Appeals (the PARTIES) reach their own negotiated settlement of the issues to be mediated. See (2) below for the participants in the mediation process. To accomplish this goal, the mediator will act as a facilitator, assist in defining the issues and promote settlement negotiations between the PARTIES. The mediator will inform and discuss with the PARTIES the rules and procedures pertaining to the mediation process. The mediator will not have settlement authority and will not render a decision regarding any issue in dispute. The PARTIES will continue to have settlement authority for all issues considered under the mediation process.

2. *Nature of Process, Participants, Withdrawal.*

(a) The mediation process is optional.

(b) The PARTIES must have participants attending the mediation session with decision-making authority. No later than two weeks before the mediation, each PARTY will submit to the other PARTY and the mediator a list of the participants who will attend the mediation session on behalf of or at the request of the party, including a designation of the person with decision-making authority who will represent the PARTY at the mediation session. Each PARTY's list of participants should contain the participant's name, the participant's position with the PARTY or other affiliation (e.g., a member of the XYZ law firm, counsel to the taxpayer), and the participant's address, [telephone number and fax number]. *All* participants attending the mediation on behalf of or at the request of a PARTY should be listed on the PARTY's list of participants, including witnesses, consultants and attorneys.

[Insert limitations on the number or types of participants, if any.]

(c) Either PARTY may withdraw from the process at any time prior to reaching a settlement of the issues to be mediated by notifying the other PARTY and the mediator in writing.

3. *Selection of Mediator, Costs.*

a [**NAME OF TAXPAYER**] and [**NAME**], Assistant Regional Director of Appeals-Large Case (ARDA-LC), by mutual agreement, will select a mediator. To facilitate the selection of a mediator, the PARTIES may agree to use any local or national organization that provides a roster of neutrals in selecting a mediator. The mediator may be a non-IRS individual or an Appeals representative, with previous mediation training or experience. Co-mediators may also be selected. A potential mediator must disclose any official, financial, or personal conflict of interest with respect to the PARTIES. Any potential mediator with any such conflict of interest may not serve as a mediator, unless such interest is fully disclosed in writing to the PARTIES and they agree that the mediator may serve. See 5 U.S.C. § 573.

b. The costs of a non-IRS mediator or co-mediator will be shared equally by the taxpayer and National Office Appeals, subject to applicable rules and regulations for Government procurement. If an Appeals mediator or co-mediator is selected, National Office Appeals will pay the costs associated with the mediator (or co-mediator). Due to the inherent conflict that results when the Appeals mediator is an employee of the IRS, Appeals will provide to the taxpayer a statement confirming the employee's proposed service as a mediator, that the person is a current employee of the IRS and that a conflict results from that mediator's continued status as an IRS employee.

4. *Issues to be Mediated.*

The mediation session will encompass the following issues in the IRS audit of [**NAME OF TAXPAYER**]'s federal tax returns:

(a) Issue #1

(b) Issue #2

5. *Submission of Materials.*

Each PARTY will present to the mediator a separate written summation not to exceed 20 pages (exclusive of exhibits consisting of pre-existing documents and reports) regarding each issue. The mediator will have the right to ask either PARTY for additional information before the mediation session if deemed necessary for a full understanding of the issues to be mediated. A copy of any submission a PARTY gives to the mediator will be provided simultaneously to the other PARTY.

6. *Place of Mediation.*

The PARTIES should attempt to select a site at or near the mediator's office, [**NAME OF TAXPAYER**]'s office, or an Appeals office.

7. *Proposed Schedule.*

Subject to the approval of the mediator, the mediation session will be conducted according to the following schedule:

Submission of Materials to Mediator:	**A DATE WHICH IS NOT LATER THAN TWO WEEKS BEFORE THE DATE OF MEDIATION SESSION**
Mediation Session:	**By MONTH DAY, YEAR and TIME**

8. *Confidentiality.*

The mediation process will be confidential. [**NAME OF TAXPAYER**] acknowledges that the mediator and the other persons invited by the PARTIES to participate in the mediation, will have access to all of [**NAME OF TAXPAYER**]'s return or return information pertaining to the issues being mediated pursuant to I.R.C. §§ 6103(b), 6103© and 6103(n) and the regulations thereunder. (See attached Consent to and Acknowledgment of Disclosure of Return and Return Information.) IRS employees involved in any way in the mediation process, and any person under contract to the IRS that the IRS invites to participate will be subject to the confidentiality and disclosure provisions of the Internal Revenue Code, including I.R.C. §§ 6103, 7213 and 7431. IRS employees, [**NAME OF TAXPAYER**], the outside mediator, and persons invited to participate by the PARTIES in the mediation shall not voluntarily, or through discovery or compulsory process, disclose any information regarding the mediation process or any communication made during the mediation process, including the settlement terms, except as provided in 5 U.S.C. § 574.

9. *I.R.C. Section 7214 (a)(8) Disclosure.*

The PARTIES to this agreement acknowledge that IRS employees involved in this mediation are bound by the I.R.C. § 7214 (a)(8) disclosure requirements concerning violations of any revenue law.

10. *No Record.*

There will be no stenographic record, no audio or video tape recording or other transcript of the mediation session(s).

11. *Report by Mediator.*

At the conclusion of the mediation session, the mediator will issue a brief report to the PARTIES identifying each issue described in section 4, above, and whether the PARTIES either agreed to resolve or did not resolve the issue.

12. *Appeals Procedures Apply.*

If the mediation process enables the PARTIES to reach agreement on the issues, established Appeals procedures will apply. Delegation Order 236 (Rev. 3) may apply to settlements resulting from the mediation process. If the PARTIES cannot reach agreement on an issue being mediated, Appeals will not reconsider it, and a statutory notice of deficiency will be issued with respect to all unagreed issues.

13. *Precedential Use.* A settlement reached by the parties through mediation will not be binding on the parties (or otherwise control) for taxable years not covered by the agreement. Except as provided in the agreement, such settlement may not be used as precedent by any party.

INTERNAL REVENUE SERVICE,
APPEALS

By:______________________________
Assistant Regional
Director of Appeals-
Large Case
Date: ______________________________

NAME OF TAXPAYER

By:______________________________
NAME
Title
Date: ______________________________

Exhibit 2:

Model Mediation Participants List

Case Name: ____

Submitted By: ____

Date: ____

Please list below all participants attending the mediation, including witnesses, consultants, and attorneys. This form must be sent to the other party and to the mediator(s) no later than two weeks before the mediation session. Insert an asterisk (*) before the name of the person who has decision-making authority at the mediation sessions:

NAME	***POSITION OR AFFILIATION***	***ADDRESS***	***TELEPHONE & FAX NUMBER***

Exhibit 3:

Model Consent to and Acknowledgment of Disclosure Of Return And Return Information

Pursuant to I.R.C. § 6103(c) and the regulations thereunder, I,__________, on behalf of __________ , (hereafter Taxpayer) authorize the Internal Revenue Service to disclose to __________, a person the Taxpayer has invited to participate in the Taxpayer's mediation with the Internal Revenue Service, all of the Taxpayer's returns and return information, within the meaning of I.R.C. §§ 6103(b)(1)—(2), pertaining to the issues being mediated.

Taxpayer also acknowledges that the Internal Revenue Service may disclose Taxpayer's returns and return information to the mediator or to persons the Internal Revenue Service may invite to participate in the Taxpayer's mediation, pursuant to I.R.C. § 6103, including I.R.C. § 6103(n).

Taxpayer understands that, without this consent to disclosure, Taxpayer's returns and return information would be confidential and disclosable only as authorized by Title 26.

I certify that I am the Taxpayer's __________, and that I have the authority to execute this consent to disclosure on the Taxpayer's behalf.

Taxpayer's Name: ____

Taxpayer's Address: ____

____

Taxpayer's Identification Number: _____________________________________

Tax period(s): ____________________ through ____________________, inclusive.

Name of person executing consent:* ____________________________________
(Please print or type)

Signature: ____

Date: ____

* If signed by taxpayer's authorized representative, attach a copy of Form 2848, Power of Attorney and Declaration of Representative.

Exhibit 4:

Model Mediator's Report

The parties below agreed to mediate their dispute on **MONTH DAY,** 199X. The parties attended a mediation session on **MONTH DAY**, 199X in an attempt to settle the following issue(s):

ISSUE:

SETTLEMENT: [ ] Yes
[ ] No
[ ] Partial

ISSUE:

SETTLEMENT: [ ] Yes
[ ] No
[ ] Partial

Settlement documents will be prepared under established Appeals procedures.

DATED this ________________________ day of _________________________________

____
/s/ Mediator

____
/s/ Party

____
/s/ Party

Announcement 98–100

The Internal Revenue Service announces today that the proposed training materials relating primarily to the application of section 119 of the Internal Revenue Code to meals provided to the employees in the hospitality industry, as described in Announcement 98–77, 1998–34 I.R.B. 30 (the Proposed Section 119 Training Materials), will not be finalized by October 31, 1998. The Service had indicated in Announcement 98–78 that it expected to finalize the training materials by that date. However, the Service has determined that it needs additional time in order to consider the comments received on the proposed training materials and to discuss such comments with the commentators.

In Announcement 98–78, 1998–34 I.R.B. 30, issued on August 4, 1998, the Service announced a settlement initiative relating to employee meals. The purpose of the initiative is to resolve certain issues quickly and eliminate the need for further potentially costly controversies for the periods covered by the settlement initiative. The settlement initiative provides that taxpayers can indicate their interest in accepting the offer no later than 30 days after the Proposed Section 119 Training Materials are finalized. Taxpayers will continue to have until 30 days after the release of final training materials to indicate an interest in the settlement initiative relating to these issues.

The Service received questions about one aspect of the settlement offer. In response to these questions, the Service clarifies that, for taxable years beginning on or after January 1, 1995 and before December 31, 1998, the taxpayer may deduct an amount of the otherwise allowable expenses for such periods, taking into account section 274(n)(1), but substituting 70% in section 274(n)(1) in place of 50%. If, for example, a taxpayer incurred $100 of allowable expenses for employee meals in the tax year beginning on January 1, 1996, section 274(n)(1) would ordinarily limit the deduction of those expenses to $50. The settlement offer, as set forth in Announcement 98–78, provides for a $70 deduction for the 1996 tax year.

For further information on the settlement initiative, contact Bob Patrick, at (702) 455-1403 (not a toll-free number). For further information on the training materials, contact Dan Bryant, Senior Analyst, Office of Employment Tax Administration and Compliance at (202) 622-3650 (not a toll-free number).

The principal author of this announcement is Thomas Burger, Director, Office of Employment Tax Administration and Compliance (OETAC). For further information regarding this announcement contact Bob Patrick at (702) 455-1403 (not a toll-free call).

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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[1] A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1998–1 through 1998–28 will be found in Internal Revenue Bulletin 1998–29, dated July 20, 1998.

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