Internal Revenue
bulletin

Bulletin No. 1999–48
November 29, 1999

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8841, page 593.

Final regulations under section 6031 of the Code relate to the filing of partnership tax returns.

T.D. 8843, page 590.

Final regulations under section 6011(e) of the Code generally require partnerships with more than 100 partners to file their partnership tax returns on magnetic media for tax years ending on or after December 31, 2000. However, electing large partnerships and partnerships using foreign addresses on their series 1065 forms are not required to file their returns on magnetic media for tax years ending before January 1, 2001.

EMPLOYEE PLANS

Rev. Rul. 99–47, page 588.

Covered compensation tables for 2000. The covered compensation tables for the year 2000 used for determining contributions to defined benefit plans and permitted disparity are set forth.

Rev. Proc. 99–44, page 598.

Insurance companies; annuity contracts. This procedure sets forth conditions under which the Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Code, notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. Rev. Rul. 81–225 modified.

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Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

The Bulletin is divided into four parts as follows:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

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

Section 61.—Gross Income Defined

26 CFR 1.61–1: Gross income.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), and 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

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

26 CFR 1.401(1)–1: Permitted disparity in employer-provided contributions or benefits.

Covered compensation tables for 2000. The covered compensation tables for the year 2000 used for determining contributions to defined benefit plans and permitted disparity are set forth.

Rev. Rul. 99–47

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 2000 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 section 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) defines the taxable wage base as the contribution and benefit base under section 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 §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 2000 year the taxable wage base is $76,200.

The following tables provide covered compensation for 2000:

2000 COVERED COMPENSATION TABLE

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2000 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
1920	1985	12,276
1921	1986	13,368
1922	1987	14,520
1923	1988	15,708
1924	1989	16,968
1925	1990	18,312

2000 COVERED COMPENSATION TABLE—Continued

CALENDAR YEAR OF BIRTH	CALENDAR YEAR OF SOCIAL SECURITY RETIREMENT AGE	2000 COVERED COMPENSATION
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	35,100
1936	2001	37,092
1937	2002	39,072
1938	2004	42,984
1939	2005	44,940
1940	2006	46,896
1941	2007	48,816
1942	2008	50,688
1943	2009	52,488
1944	2010	54,252
1945	2011	55,992
1946	2012	57,708
1947	2013	59,376
1948	2014	60,900
1949	2015	62,340
1950	2016	63,660
1951	2017	64,920
1952	2018	66,072
1953	2019	67,164
1954	2020	68,220
1955	2022	70,116
1956	2023	71,004
1957	2024	71,820
1958	2025	72,528
1959	2026	73,176
1960	2027	73,764
1961	2028	74,304
1962	2029	74,748
1963	2030	75,180
1964	2031	75,564
1965	2032	75,864
1966	2033	76,092
1967 or later	2034	76,200

2000 Rounded Covered Compensation Table

Year of Birth	Covered Compensation
1934	$33,000
1935 – 1936	36,000
1937	39,000
1938	42,000
1939	45,000
1940 – 1941	48,000
1942 – 1943	51,000
1944	54,000
1945 – 1946	57,000
1947 – 1948	60,000
1949 – 1950	63,000
1951 – 1953	66,000
1954 – 1955	69,000
1956 – 1959	72,000
1960 – 1964	75,000
1965 or later	76,200

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 403.—Taxation of Employee Annuities

26 CFR 1.403(a)–1: Taxability of beneficiary under a qualified annuity plan.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

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26 CFR 1.403(b)–1: Taxability of beneficiary under annuity purchased by section 501(c)(3) organization or public school.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 408.—Individual Retirement Accounts

26 CFR 1.408–1: General rules.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 817.—Treatment of Variable Contracts

26 CFR 1.817–5: Diversification requirements for variable annuity, endowment, and life insurance contracts.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 818.—Other Definitions and Special Rules

26 CFR 1.818–2: Accounting provisions.

The circumstances are set forth under which the Internal Revenue Service will treat a contract as an annuity contract described in sections 403(a), 403(b), or 408(b) of the Internal Revenue Code notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities. See Rev. Proc. 99–44, page 598.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 301.6011–3: Required use of magnetic media for partnership returns.

T.D. 8843

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Partnership Returns Required on Magnetic Media

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the requirements for filing partnership returns on magnetic media. These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. These regulations affect partnerships with more than 100 partners.

DATES: *Effective Date:* These regulations are effective January 1, 2000.

Applicability Date: These regulations apply to partnership returns for taxable years ending on or after December 31, 2000. However, the regulations will not apply to electing large partnership returns under section 775 or partnership returns with foreign addresses for taxable years ending before January 1, 2001.

FOR FURTHER INFORMATION CONTACT: Bridget E. Finkenaur, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to filing partnership returns on magnetic media under section 6011(e)(2). In addition, this document contains conforming amendments to the Regulations on Procedure and Administration (26 CFR part 301) relating to information reporting penalties under section 6721.

A notice of proposed rulemaking (REG–102023–98, 1998–48 I.R.B. 6) was published in the **Federal Register** (63 F.R. 56878) on October 23, 1998. The public hearing scheduled for January 13, 1999, was canceled in the **Federal Register** (64 F.R. 1148) on January 8, 1998. No public hearing was requested or held. Two written comments were received. After consideration of the comments, the proposed regulations are adopted as modified by this Treasury decision. The comments are discussed below.

Explanation of Revisions and Summary of Comments

Both commentators requested that the IRS and the Treasury Department post-

pone the effective date of the regulations. The commentators were concerned that, given the various manners and formats that nominees use to submit partner information to publicly traded partnerships, these partnerships would be unable to create computer programs that would reformat the partner information in time to file their 1999 tax returns on magnetic media. In addition, partnerships required to file their returns on magnetic media beginning in 2000 will be focusing their computer resources on ensuring that their computer systems are year 2000 compliant. The commentators suggested that the effective date of the regulations be postponed to take into account these programming considerations.

In considering these comments, the IRS and the Treasury Department have decided to postpone the general effective date of the regulations for one year. This will allow partnerships additional time to develop systems that accommodate IRS processing requirements and integrate third party information while not interfering with efforts to ensure year 2000 compliance. Therefore, the final regulations are generally effective for taxable years ending on or after December 31, 2000. However, the effective date for electing large partnerships and partnerships using foreign addresses on their Series 1065 forms remains the same as the proposed regulations. Accordingly, electing large partnerships and partnerships using foreign addresses will not be required to file their returns on magnetic media for taxable years ending before January 1, 2001.

Although the general effective date of the regulations has been postponed, on March 15, 2000, the IRS will begin accepting partnership returns for taxable years ending on or after December 31, 1999, on magnetic media. The magnetic media filing of partnership returns for taxable years ending before December 31, 2000, is voluntary; partnerships will not be penalized for submitting a partnership return on paper for taxable years ending before this date. However, partnerships with the capability of submitting their partnership tax returns on magnetic media are encouraged to do so.

Partnerships with 100 or fewer partners also may voluntarily submit partnership returns on magnetic media beginning on March 15, 2000. These regulations do not require partnerships with 100 or fewer partners to file their returns on magnetic media; therefore, such partnerships will not be penalized for their failure to do so. In addition, partnerships with 100 or fewer partners participating in the magnetic media filing program may discontinue their participation at any time.

One commentator suggested that the IRS and the Treasury Department publish regulations under section 6031(c) to require nominees holding partnership interests to submit partner information to partnerships in the same manner and format that the IRS requires partnerships to file their returns under §301.6011-3 of the regulations. However, by postponing the effective date, it is anticipated that partnerships and nominees will have adequate time to establish satisfactory guidelines for sharing information. Accordingly, this comment has not been adopted by the final regulations.

Finally, one commentator asked whether fiscal year and short year returns will be required to be filed on magnetic media by the general effective date. Again, because the IRS and the Treasury Department have postponed the general effective date for one year, it is anticipated that partnerships will be able to meet the systems requirements set forth in IRS revenue procedures and other published guidance by the effective date. However, due to issues relating to creation of the system for accepting returns on magnetic media, the IRS will not be able to accept fiscal and short year returns prior to the general effective date. Therefore, partnerships that use a fiscal year and partnerships that must file a short year return may not voluntarily file their returns on magnetic media before January 1, 2001.

As indicated in the preamble to the proposed regulations, although the regulations define magnetic media broadly, the Service currently plans, in prescribed procedures for participation in the mandatory magnetic media filing program, to require partnerships with more than 100 partners to file their partnership returns electronically.

Special Analyses

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

Drafting Information

The principal author of these regulations is Bridget E. Finkenaur, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and Treasury Department participated in the development of these regulations.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by adding an entry in numerical order to read in part as follows:

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

Section 301.6011–3 also issued under 26 U.S.C. 6011; * * *

Par. 2. Section 301.6011–3 is added to read as follows:

§301.6011–3 Required use of magnetic media for partnership returns.

(a) *Partnership returns required on magnetic media.* If a partnership with more than 100 partners is required to file a partnership return pursuant to §1.6031(a)–1 of this chapter, the information required by the applicable forms and schedules must be filed on magnetic media, except as otherwise provided in paragraph (b) of this section. Returns filed on magnetic media must be made in accordance with applicable revenue procedures or publications. In prescribing

revenue procedures or publications, the Commissioner may determine that partnerships will be required to use any one form of magnetic media filing. For example, the Commissioner may determine that partnerships with more than 100 partners must file their partnership returns electronically. In filing its return, a partnership must register to participate in the magnetic media filing program in the manner prescribed by the Internal Revenue Service in applicable revenue procedures or publications.

(b) *Waiver.* The Commissioner may waive the requirements of this section if hardship is shown in a request for waiver filed in accordance with this paragraph (b). A determination of hardship will be based upon all of the facts and circumstances. One factor in determining hardship will be the reasonableness of the incremental cost to the partnership of complying with the magnetic media filing requirements. Other factors, such as equipment breakdowns or destruction of magnetic media filing equipment, also may be considered. A request for waiver must be made in accordance with applicable revenue procedures or publications. The waiver will specify the type of partnership return and the period to which it applies. The waiver will also be subject to such terms and conditions regarding the method of filing as may be prescribed by the Commissioner.

(c) *Failure to file.* If a partnership fails to file a partnership return on magnetic media in the manner required and when required to do so by this section, the partnership will be deemed to have failed to file the return in the manner prescribed for purposes of the information return penalty under section 6721. See §301.6724–1(c)(3) for rules regarding the waiver of penalties for undue economic hardship relating to filing returns on magnetic media.

(d) *Meaning of terms.* The following definitions apply for purposes of this section:

(1) *Magnetic media.* The term magnetic media means any *magnetic media* permitted under applicable regulations, revenue procedures, or publications. These generally include magnetic tape, tape cartridge, and diskette, as well as other media (such as electronic filing) specifically permitted under the applicable regulations, procedures, or publications.

(2) *Partnership.* The term *partnership* means a partnership as defined in §1.761–1(a) of this chapter.

(3) *Partner.* The term *partner* means a member of a partnership as defined in section 7701(a)(2).

(4) *Partnership return.* The term *partnership return* means a form in Series 1065 (including Form 1065, U.S. Partnership Return of Income, and Form 1065-B, U.S. Return of Income for Electing Large Partnerships), along with the corresponding Schedules K-1 and all other related forms and schedules that are required to be attached to the Series 1065 form.

(5) *Partnerships with more than 100 partners.* A partnership has more than 100 partners if, over the course of the partnership's taxable year, the partnership had more than 100 partners, regardless of whether a partner was a partner for the entire year or whether the partnership had over 100 partners on any particular day in the year. For purposes of this paragraph (d)(5), however, only those persons having a direct interest in the partnership must be considered partners for purposes of determining the number of partners during the partnership's taxable year.

(e) *Examples.* The following examples illustrate the provisions of paragraph (d)(5) of this section. In the examples, the partnerships utilize the calendar year, and the taxable year in question is 2000:

Example 1. Partnership P had five general partners and 90 limited partners on January 1, 2000. On March 15, 2000, 10 more limited partners acquired an interest in P. On September 29, 2000, the 10 newest partners sold their individual partnership interests to C, a corporation which was one of the original 90 limited partners. On December 31, 2000, P had the same five general partners and 90 limited partners it had on January 1, 2000. P had a total of 105 partners over the course of partnership taxable year 2000. Therefore, P must file its 2000 partnership return on magnetic media.

Example 2. Partnership Q is a general partnership that had 95 partners on January 1, 2000. On March 15, 2000, 10 partners sold their individual partnership interests to corporation D, which was not previously a partner in Q. On September 29, 2000, corporation D sold one-half of its partnership interest in equal shares to five individuals, who were not previously partners in Q. On December 31, 2000, Q had a total of 91 partners, and on no date in the year did Q have more than 100 partners. Over the course of the year, however, Q had 101 partners. Therefore, Q must file its 2000 partnership return on magnetic media.

Example 3. Partnership G is a general partnership with 100 partners on January 1, 2000. There are no new partners added to G in 2000. One of G's partners, A, is a partnership with 53 partners. A is one partner, regardless of the number of partners A has. Therefore, G has 100 partners and is not required to file its 2000 partnership return on magnetic media.

(f) *Effective date.* In general, this section applies to partnership returns for taxable years ending on or after December 31, 2000. However, electing large partnerships under section 775 and partnerships using foreign addresses on their Series 1065 forms are not required to file using magnetic media for taxable years ending before January 1, 2001.

Par. 3. Section 301.6721–1 is amended by removing the third, fourth, and fifth sentences of paragraph (a)(2)(ii) and adding four sentences in their place to read as follows:

§301.6721–1 Failure to file correct information returns.

(a) * * *

(2) * * *

(ii) * * * However, no penalty is imposed under paragraph (a)(1) of this section solely by reason of any failure to comply with the requirements of section 6011(e)(2), except to the extent that such a failure occurs with respect to more than 250 information returns (the 250-threshold requirement) or in the case of a partnership with more than 100 partners, more than 100 information returns (the 100-threshold requirement) (collectively, the threshold requirements). Each Schedule K-1 considered in applying the 100-threshold requirement will be treated as a separate information return. These threshold requirements apply separately to each type of information return required to be filed. Further, these threshold requirements apply separately to original and corrected returns. * * *

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Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Joseph Mikrut,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 10, 1999, 8:45 a.m., and published in the

issue of the Federal Register for November 12, 1999, 64 F.R. 61502)

Section 6031.—Return of Partnership Income

26 CFR 1.6031(a)–1: Return of partnership income.

T.D. 8841

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

Return of Partnership Income

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations revising the partnership filing requirement. These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997 (TRA). All partnerships required to file partnership returns, including certain foreign partnerships, are affected by these regulations.

DATES: *Effective Dates:* These regulations are effective January 1, 2000, except that §1.6031(a)–1(b)(3) is effective January 1, 2001.

Applicability Dates: For dates of applicability, see §§1.6031(a)–1(f) and 1.6063–1(c)(2).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Martin Schäffer, 202-622-3070; concerning foreign partnerships, Guy A. Bracuti, 202-622-3860 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1583.

The collection of information in these final regulations is in §1.6031(a)–1. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or claiming the correct amount of losses, deductions, or credits from that taxpayer's interest in the partnership.

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

The burden is reflected in the burden estimate of Form 1065.

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, T: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 might become material in the administration of any internal revenue law. Generally, tax returns and tax return information are confidential, as required by 26 U.S.C. 6103.

Background

On January 26, 1998, the IRS and Treasury published in the **Federal Register** (63 F.R. 3677) proposed amendments to the regulations (REG–209322–82, 1998–15 I.R.B. 26) under sections 6031 and 6063 of the Internal Revenue Code (Code). These amendments were designed, in part, to reflect changes made to section 6031 of the Code by section 1141 of TRA, Public Law 105-34 (111 Stat. 788). Written comments responding to these proposed regulations were received. No public hearing was requested or held. After consideration of all the comments, the proposed regulations under sections 6031 and 6063 of the Code are adopted as revised by this Treasury decision, and the current final regulations under section 6031 of the Code are removed.

Explanation of Revisions and Summary of Comments

A. General Filing Requirements for Foreign Partnerships

Section 6031(a) of the Code requires every partnership to file a partnership return. However, section 6031(e) of the Code provides that a foreign partnership is not required to file a return for a taxable year unless during that year it derives gross income from sources within the United States (U.S.-source income) or has gross income that is effectively connected with the conduct of a trade or business within the United States (ECI).

Consistent with section 6031(e) of the Code, the proposed regulations generally required a foreign partnership to file a return under section 6031 of the Code if it had either U.S.-source income or ECI. This general rule is adopted without change in the final regulations.

B. Exceptions to General Filing Requirements

Under the proposed regulations, a foreign partnership that had no ECI, and that otherwise was required to file a partnership return only because it had U.S.-source income, was exempt from the requirement to file a partnership return if (i) no United States person had a direct or indirect interest in the partnership; (ii) the U.S.-source income was either fixed or determinable annual or periodical income described in §1.1441–2(b) or other amounts subject to withholding described in §1.1441–2(c); (iii) Forms 1042 and 1042-S were filed with respect to all such gross income by the partnership, or by another withholding agent (or agents) if the partnership was not required to file such forms; and (iv) the tax liability of the partners with respect to such gross income was fully satisfied by the withholding of tax at source. Most of the written comments received with respect to the proposed regulations requested that the IRS and Treasury modify this proposed exception to the foreign partnership filing requirement.

In response to these comments, the final regulations liberalize the exceptions in certain instances for foreign partnerships that have U.S.-source income but no ECI. The changes are designed to reduce duplicative filing requirements where other information reporting and withholding requirements provide adequate protection for the tax system and to recognize that where there is de minimis ownership in a foreign partnership by U.S. partners, the return filing requirements should not be invoked merely because the partnership earns any amount of U.S.-source income.

The final regulations contain three rules that modify the reporting obligations

of certain foreign partnerships that have no ECI. These modified reporting rules, with the exception of the de minimis exception, are applicable for partnership taxable years beginning after December 31, 2000, because they are dependent on rules contained in §§1.1441–5(c) and 1.1461–1, which will be applicable only after December 31, 2000. See Notice 99–27 (1999–20 I.R.B. 75). The de minimis exception, however, will be effective for partnership taxable years beginning after December 31, 1999, the general effective date of these regulations.

The modified reporting rules contain some common requirements. None of these rules will apply to a withholding foreign partnership (as defined in §1.1441–5(c)(2)(i)). Also, with the exception of the de minimis rule, the modified reporting rules will apply only when one or more withholding agents file the required Forms 1042 and 1042-S and pay the associated withholding tax.

The first modified reporting rule is the *de minimis* exception. This rule provides that a foreign partnership (other than a withholding foreign partnership, as defined in §1.1441–5(c)(2)(i)) with $20,000 or less of U.S.-source income and no ECI is required to file a partnership return only if one percent or more of any item of partnership gain, loss, deduction, or credit is allocable in the aggregate to direct U.S. partners.

The second modified reporting rule, which also was contained in the proposed regulations, provides that a foreign partnership with U.S.-source income but no ECI and no U.S. partners is not required to file a partnership return. Under the third rule, a foreign partnership with U.S.-source income and one or more U.S. partners but no ECI must file a partnership return. However, such a partnership need file Schedules K-1 only for its direct U.S. partners and for its passthrough partners through which U.S. partners hold an interest in the foreign partnership.

The final regulations do not require a foreign partnership to provide Schedules K-1 for foreign partners deriving U.S.-source income that is not ECI, because the foreign partners are subject to information reporting on Forms 1042-S under the rules contained in §§1.1441–5(c) and 1.1461–1 of the regulations. These rules generally subject the foreign partners, and not the partnership, to an information reporting regime with respect to U.S.-source income (that is not ECI) paid to a foreign partnership. To the extent that information returns are not required for foreign partners under section 1461 of the Code, the IRS and Treasury have determined that reporting under section 6031 of the Code is unnecessary as long as the foreign partnership has no ECI. Accordingly, a foreign partnership with no ECI need not report on a Schedule K-1 a foreign partner's allocable share of items of income, including U.S.-source gains that are not subject to Form 1042-S reporting, deposit interest under section 871(i) of the Code, and interest or OID on short-term obligations under section 871(g) of the Code.

In contrast to the rule for U.S.-source income, the exception to Schedule K-1 reporting does not apply to a foreign partner's allocable share of ECI. Under the information reporting rules in §§1.1441–5(c)(1)(ii)(B) and 1.1461–1(c) of the regulations, ECI must be reported to a foreign partnership rather than to the foreign partners directly. In addition, because ECI is subject to tax on a net basis, a foreign partnership must provide a foreign partner's allocable share of other items of partnership income, gain, loss, or deduction to properly calculate the net taxable income. Therefore, if a foreign partnership has ECI, it must file a complete partnership return (with Schedules K-1 for all partners) reflecting all items of partnership income, gain, loss, deduction, and credit.

C. Partners That are Controlled Foreign Corporations

One commentator suggested that a foreign partnership should not have to file under section 6031 of the Code if it has no direct U.S. partners and its only U.S.-source income is bank deposit interest under section 871(i) of the Code. The exception to the filing requirement in §1.6031(a)–1(b)(2) of the proposed regulations did not apply to foreign partnerships with direct or indirect U.S. partners. Thus, according to the commentator, this exception did not apply to a common, nonabusive situation in which a controlled foreign corporation (CFC) is a partner in a foreign partnership whose only U.S.-source income is interest earned on a U.S. bank account. (Foreign partners do not owe U.S. tax on this interest income; see section 871(i) of the Code and §1.1441–2(a) of the regulations (final sentence). In addition, a U.S. person who controls a CFC must report such income on Form 5471; see §1.6038–2.)

The term indirect interest was not defined in the proposed regulations. Thus, whether a U.S. shareholder of a CFC partner held an indirect interest in the foreign partnership was not clear. These final regulations define the term *United States partner* as any U.S. person owning a direct or indirect interest in the foreign partnership. An indirect interest is defined as any interest held through one or more passthrough partners (as defined in section 6231(a)(9) of the Code). A passthrough partner is a partnership, estate, trust, S corporation, nominee, or other similar person. Because a CFC is not a passthrough partner, the U.S. shareholder of a CFC has no indirect interest in the foreign partnership under these final regulations. Accordingly, a partnership with no ECI need not file a return solely as a result of having a CFC partner.

D. Responsibility to Ensure Filing of Forms 1042 and 1042-S and Payment of Associated Tax

As stated above, a foreign partnership may avail itself of the modified filing requirements in §1.6031(a)–1(b)(3) of these regulations, for partnership taxable years beginning after December 31, 2000, only if it or another withholding agent actually files the Forms 1042 and 1042-S and pays the associated tax. A commentator suggested that a foreign partnership with no withholding responsibility should not have the burden of ensuring that another withholding agent has properly filed Forms 1042-S in order to invoke the modified filing requirements.

Where a withholding agent fails to withhold (and to file the requisite forms) with respect to a partner in a foreign partnership, the Service might be unable to assess and collect the proper tax without information from a partnership return. A partnership return provides the Service with the name of the foreign partner and the amount subject to withholding. Accordingly, these final regulations do not adopt the comment.

While this comment is not adopted, certain relief still may be available. Each

person who has control, receipt, custody, or payment of an amount subject to withholding is a withholding agent and is responsible for withholding tax and filing Forms 1042 and 1042-S. Generally, a foreign partnership is a withholding agent and must withhold tax and file the requisite forms. Under §1.1461–1(b) and (c), one withholding agent among several may be relieved of its responsibility to withhold if another withholding agent withholds tax and files the proper returns. However, §1.1441–5(c)(3)(v) augments this rule by deeming a foreign partnership (other than a withholding foreign partnership as defined in §1.1441–5(c)(2)(i)) to have satisfied its withholding responsibilities for an amount with respect to a partner to the extent that the partner's distributive share of the payment can be reliably associated with a withholding certificate described in §1.1441–5(c)(3)(iii) pertaining to the partner that the partnership has furnished to a withholding agent, and the partnership does not know or has no reason to know that the correct amount has not been withheld. These final regulations do not alter the result under §1.1441–5(c)(3)(v). In addition, if a foreign partnership reasonably relies on a modified filing requirement under these regulations, but the modification is inapplicable because no party has satisfied withholding responsibilities, the partnership should be able to show that its failure to file a partnership return was due to reasonable cause for purposes of section 6698 of the Code if the foreign partnership is deemed to have satisfied its withholding responsibilities under §1.1441–5(c)(3)(v).

E. Partnership Level Elections under Section 703 of the Code

A commentator suggested that an abbreviated return should be permitted where a foreign partnership would be exempt from the filing requirement but for a partnership level election under section 703 of the Code. These final regulations clarify that a return filed solely to make an election under section 703 of the Code need contain only information identifying the partnership and the type of election. In general, such a return is not considered to be a return filed under section 6031(a) of the Code. Therefore, a return filed solely to make an election is not a partnership return for purposes of section 6501 (regarding the statute of limitations) and sections 6231(a)(1)(A) and 6233 (regarding the partnership audit rules) of the Code.

Section 1.6031(a)–1(b)(3)(ii) of the proposed regulations provided that a return filed by or for a foreign partnership to make a section 703 election must be signed by each partner who was a partner at the time of election or by any partner who was authorized (under local law or the partnership's organizational documents) to make the election and who represented having such authority under penalties of perjury. A commentator suggested that the signature requirement for returns filed solely to make a partnership level election should be restricted to partners who are U.S. persons or are owned directly or indirectly by U.S. persons. These final regulations do not adopt this comment but maintain the signature requirement as proposed. Cf. §301.7701–3(c)(2) setting forth the same signature requirement for entity classification elections.

F. Electing Out of Subchapter K under Section 761 of the Code

A commentator suggested that the final regulations should provide a default rule under which a foreign partnership with no direct U.S. partners that is eligible to elect out of subchapter K of the Code would be deemed to have elected exclusion. Under §1.6031(a)–1(c)(2) of the proposed regulations, a partnership that was deemed to have elected exclusion from subchapter K, as specified in §1.761–2(b)(2)(ii), would be exempt from the partnership filing requirement. According to the commentator, for joint ventures in which all the direct owners are foreign, it is often difficult to clearly demonstrate an intention to exclude the entity from U.S. partnership treatment, as required by the section 761 regulations. To avoid inconsistency with the requirements for deemed exclusion under section 761 of the Code, these final regulations maintain the rule as proposed.

Special Analyses

It has been determined that these regulations are not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations would reduce (rather than increase) the number of small entities that are required to file a partnership return. Specifically, the regulations eliminate the filing requirements for certain foreign partnerships that are fully subject to withholding in order to prevent duplicative filing requirements. In addition to eliminating the filing requirements in these circumstances, for ease of reference, the regulations update and restate the general requirements to file a partnership return as set forth in existing regulations. Because these regulations do not impose any new reporting requirements that are not imposed by the existing regulations, and the only significant modification of the existing regulations is to eliminate the filing requirement for certain foreign partnerships, the regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the proposed regulations preceding these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal authors of these regulations are Martin Schäffer, Office of Assistant Chief Counsel (Passthroughs and Special Industries), and Guy A. Bracuti, Office of Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

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 an entry in numerical order to read in part as follows:

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

Section 1.6031(a)-1 also issued under 26 U.S.C. 6031. * * *

§1.6031–1 [Removed]

Par. 2. Section 1.6031–1 is removed.

Par. 3. Section 1.6031(a)–1 is added to read as follows:

§1.6031(a)–1 Return of partnership income.

(a) *Domestic partnerships*—(1) *Return required.* Except as provided in paragraphs (a)(3) and (c) of this section, every domestic partnership must file a return of partnership income under section 6031 (partnership return) for each taxable year on the form prescribed for the partnership return. The partnership return must be filed for the taxable year of the partnership regardless of the taxable years of the partners. For taxable years of a partnership and of a partner, see section 706 and §1.706–1. For the rules governing partnership statements to partners and nominees, see §1.6031(b)–1T.

(2) *Content of return.* The partnership return must contain the information required by the prescribed form and the accompanying instructions.

(3) *Special rule.* A partnership that has no income, deductions, or credits for federal income tax purposes for a taxable year is not required to file a partnership return for that year.

(4) *Failure to file.* For the consequences of a failure to comply with the requirements of section 6031(a) and this paragraph (a), see sections 6229(a), 6231(f), 6698, and 7203.

(b) *Foreign partnerships*—(1) *General rule.* A foreign partnership is not required to file a partnership return, if the foreign partnership does not have gross income that is (or is treated as) effectively connected with the conduct of a trade or business within the United States (ECI) and does not have gross income (including gains) derived from sources within the United States (U.S.-source income). Except as provided in paragraphs (b)(2) and (3) of this section, a foreign partnership that has ECI or has U.S.-source income that is not ECI must file a partnership return for its taxable year in accordance with the rules for domestic partnerships in paragraph (a) of this section.

(2) *Foreign partnerships with de minimis U.S.-source income and de minimis U.S. partners.* A foreign partnership (other than a withholding foreign partnership, as defined in §1.1441–5(c)(2)(i)) that has $20,000 or less of U.S.-source income and has no ECI during its taxable year is not required to file a partnership return if, at no time during the partnership taxable year, one percent or more of any item of partnership income, gain, loss, deduction, or credit is allocable in the aggregate to direct United States partners. The United States partners must directly report their shares of the allocable items of partnership income, gain, loss, deduction, and credit.

(3) *Filing obligations for certain other foreign partnerships with no ECI*—(i) *General requirements for modified filing obligations.* A foreign partnership will be subject to the modified filing obligations in paragraphs (b)(3)(ii) and (iii) of this section if, in addition to satisfying the requirements contained in paragraph (b)(3)(ii) and (iii) of this section—

(A) The partnership is not a withholding foreign partnership as defined in §1.1441–5(c)(2)(i);

(B) Forms 1042 and 1042-S are filed by the partnership with respect to the amounts subject to reporting under §1.1461–1(b) and (c), unless the partnership is not required to file such returns under §1.1461–1(b)(2) and (c)(4), in which case Forms 1042 and 1042-S must be filed by another withholding agent or agents; and

(C) The tax liability of the partners with respect to such amounts has been fully satisfied by the withholding of tax at the source, if applicable, under chapter 3 of the Internal Revenue Code.

(ii) *Foreign partnerships with U.S.-source income but no U.S. partners.* A foreign partnership that has U.S.-source income is not required to file a partnership return if the partnership has no ECI and no United States partners at any time during the partnership's taxable year.

(iii) *Foreign partnerships with U.S.-source income and U.S. partners.* Except as provided in paragraph (b)(2) of this section, a foreign partnership with one or more United States partners that has U.S.-source income but no ECI must file a partnership return. However, such a foreign partnership need not file Statements of Partner's Share of Income, Credit, Deduction, Etc. (Schedules K-1) for any partners other than its direct United States partners and its passthrough partners (whether U.S. or foreign) through which United States partners hold an interest in the foreign partnership. Schedules K-1 that are not excepted from filing under this paragraph (b)(3)(iii) must contain the same information required of a domestic partnership filing under paragraph (a) of this section.

(4) *Information or returns required of partners who are United States persons*—(i) *In general.* If a United States person is a partner in a partnership that is not required to file a partnership return, the district director or director of the relevant service center may require that person to render the statements or provide the information necessary to verify the accuracy of the reporting by that person of any items of partnership income, gain, loss, deduction, or credit.

(ii) *Controlled foreign partnerships.* Certain United States persons who are partners in a foreign partnership controlled (within the meaning of section 6038(e)(1)) by United States persons may be required to provide information with respect to the partnership under section 6038.

(5) *Certain partnership elections.* For a partnership that is not otherwise required to file a partnership return, if an election that can only be made by the partnership under section 703 (affecting the computation of taxable income derived from a partnership) is to be made by or for the partnership, a return on the form prescribed for the partnership return must be filed for the partnership. Unless otherwise provided in the form or the accompanying instructions, a return filed solely to make an election need only contain a written statement citing paragraph (b)(5)(ii) of this section, listing the name and address of the partnership making the election, and clearly identifying the specific election being made. A return filed under paragraph (b)(5)(ii) of this section solely to make an election is not a partnership return. Thus, such a return is not a return filed under section 6031(a) for pur-

poses of sections 6501 (except regarding the specific election issue), 6231(a)-(1)(A), and 6233. The return must be signed by—

(i) Each partner that is a partner in the partnership at the time the election is made; or

(ii) Any partner of the partnership who is authorized (under local law or the partnership's organizational documents) to make the election and who represents to having such authorization under penalties of perjury.

(6) *Exclusion for certain organizations.* The return requirement of section 6031 and this section does not apply to the International Telecommunications Satellite Organization, the International Maritime Satellite Organization, or any organization that is a successor of either.

(c) *Partnerships excluded from the application of subchapter K of the Internal Revenue Code*—(1) *Wholly excluded*—(i) *Year of election.* An eligible partnership as described in §1.761-2(a) that elects to be excluded from all the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified by §1.761–2(b)(2)(i) must timely file the form prescribed for the partnership return for the taxable year for which the election is made. In lieu of the information otherwise required, the return must contain or be accompanied by the information required by §1.761–2(b)(2)(i).

(ii) *Subsequent years.* Except as otherwise provided in paragraph (c)(1)(i) of this section, an eligible partnership that elects to be wholly excluded from the application of subchapter K is not required to file a partnership return.

(2) *Deemed excluded.* An eligible partnership that is deemed to have elected exclusion from the application of subchapter K beginning with its first taxable year, as specified in §1.761–2(b)(2)(ii), is not required to file a partnership return.

(d) *Definitions*—(1) *Partnership.* For the meaning of the term partnership, see §1.761–1(a).

(2) *United States person.* In applying this section, a United States person is a person described in section 7701(a)(30); the government of the United States, a State, or the District of Columbia (including an agency or instrumentality thereof); or a corporation created or organized in Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, and American Samoa, if the requirements of section 881(b)(1)(A), (B), and (C) are met for such corporation. The term does not include an alien individual who is a resident of Puerto Rico, Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, or American Samoa, as determined under §301.7701(b)–1(d) of this chapter.

(3) *United States partner.* In applying this section, a United States partner is any United States person who holds a direct or indirect interest in the partnership.

(4) *Indirect interest.* An indirect interest is any interest held through one or more passthrough partners, as defined in section 6231(a)(9).

(e) *Procedural requirements*—(1) *Place for filing.* The return of a partnership must be filed with the service center prescribed in the relevant IRS revenue procedure, publication, form, or instructions to the form (see §601.601(d)(2)).

(2) *Time for filing.* The return of a partnership must be filed on or before the fifteenth day of the fourth month following the close of the taxable year of the partnership.

(3) *Magnetic media filing.* For magnetic media filing requirements with respect to partnerships, see section 6011(e)(2) and the regulations thereunder.

(f) *Effective dates.* This section applies to taxable years of a partnership beginning after December 31, 1999, except that paragraph (b)(3) of this section applies to taxable years of a foreign partnership beginning after December 31, 2000.

Par. 4. Section 1.6063–1 is amended by adding paragraph (c) to read as follows:

§1.6063–1 Signing of returns, statements, and other documents made by partnerships.

* * * * *

(c) *Certain partnership elections*—(1) *In general.* For rules regarding the authority of a partner to sign a partnership return filed solely for the purpose of making certain partnership-level elections, see §1.6031(a)–1(b)(5)(ii).

(2) *Effective date.* Paragraph (c) of this section applies to taxable years of a partnership beginning after December 31, 1999.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 5. The authority citation for part 301 continues to read in part as follows:

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

§301.6031–1 [Removed]

Par. 6. Section 301.6031–1 is removed.

Par. 7. Section 301.6031(a)–1 is added to read as follows:

§301.6031(a)–1 Return of partnership income.

For provisions relating to the requirement of returns of partnership income, see §1.6031(a)–1 of this chapter.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 8. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 9. In §602.101, paragraph (b) is amended by removing the entry "1.6031–1" from the table and adding the entry "1.6031(a)–1 . . . . 1545–1583" in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6031(a)–1	1545–1583
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 29, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 10, 1999, 8:45 a.m., and published in the issue of the Federal Register for November 12, 1999, 64 F.R. 61498)

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters. (Also sections 61, 403(a), 403(b), 408(b), 817(h), 818(a); 1.61–1, 1.403(a)–1, 1.403(b)–1, 1.408–1, 1.817–5, 1.818–2)

Rev. Proc. 99–44

SECTION 1. PURPOSE

This revenue procedure sets forth the circumstances under which the Internal Revenue Service will treat a contract as an annuity contract described in §§ 403(a), 403(b) or 408(b) of the Internal Revenue Code ("Code") notwithstanding that contract premiums are invested at the direction of the contract holder in publicly available securities.

SECTION 2. BACKGROUND

Rev. Rul. 77–85, 1977–1 C.B. 12, concludes that if a contract holder retains control over the assets in a custodial account associated with a purported "annuity" contract, then the contract holder is the owner of those assets for federal income tax purposes. The contract holder's gross income, therefore, includes any interest, dividends, and other income generated by those assets. In the ruling, the contract holder's control over the assets in the custodial account is manifested by the ability to direct the custodian: (1) to invest amounts in the account in any of an approved list of investments, and (2) to sell, purchase, or exchange securities or other assets held in the account. Through the interaction of the custodial agreement and the annuity contract, the contract holder enjoys any increase or suffers any decrease in the value of the assets in the account as well as any income from the assets. The contract holder also has the right to vote account securities either through the custodian or personally. Rev. Rul. 77–85 generally applies to contracts entered into after March 9, 1977.

In Rev. Rul. 80–274, 1980–2 C.B. 27, an insurance company and a savings and loan association enter into a group annuity contract under which the association's depositors are issued annuity certificates. The certificate holders' premiums (net of sales and other expenses) are invested in certificates of deposit issued by the savings and loan association, with maturity dates designated by the certificate holders. When a certificate of deposit matures, the proceeds generally are invested in another certificate of deposit with the savings and loan association. Prior to the annuity starting date, a holder of an annuity certificate can withdraw part or all of his or her investment (including the investment income thereon) by partially or completely surrendering the certificate. Due to fees imposed by the insurance company, annuity certificate holders receive a lower rate of return than if they were to invest directly in the certificates of deposit. The ruling concludes, however, that, prior to the annuity starting date, the position of holders of the annuity certificates is substantially identical to what their position would have been if investments were directly maintained or established with the savings and loan association, with the insurance company acting merely as a conduit.

Rev. Rul. 81–225, 1981–2 C.B. 12, analyzes five situations involving purported variable "annuity" contracts. In four of the situations, the ruling concludes that the contracts are not annuity contracts described in §§ 403(a), 403(b), or 408(b) and that prior to the annuity starting date the contract holders are the owners of the assets held by the insurance company with regard to the contracts. In these situations, the insurance company holds shares of mutual funds that are directly or indirectly available to the public. In the fifth situation, the contract holder can invest only in a non-publicly-available mutual fund managed by the insurance company or one of its affiliates. The shares in that mutual fund are available only through the purchase of an annuity contract. In this situation, the ruling concludes that the insurance company is treated as the owner of the mutual fund shares held by the company for the contracts. Rev. Rul. 80–274 did not address the treatment of contracts described in §§ 403(a), 403(b) or 408(b). For that reason, Rev. Rul. 81–225 contains a special transition rule for such contracts. This rule provides that any contract entered into on or before September 25, 1981, is treated as an annuity contract if the arrangement would have met the requirements imposed by those sections without taking the holding or rationale of Rev. Rul. 81–225 into account, and no contributions are made on behalf of any individual who was not included under the contract on or before September 25, 1981.

In Rev. Rul. 82–54, 1982–1 C.B. 11, a variable annuity contract holder can direct that the consideration paid for the contracts be invested in any or all of three non-publicly-available mutual funds managed by the insurance company. Each of the funds has a different general investment strategy. One fund invests primarily in common stocks, another in bonds, and the third in money market instruments. A contract holder is free to allocate payments among the three funds and to reallocate account values among the three funds at any time before the annuity starting date. The ruling concludes that the contract holder's ability to choose among broad general investment strategies, either at the time of the initial purchase of the annuity contract or subsequent thereto, does not constitute sufficient control over individual investment decisions so as to cause the contract holder to be the owner of the mutual fund shares.

Rev. Rul. 82–55, 1982–1 C.B. 12, clarifies that, if an annuity contract holder's premiums are invested in a separate account that holds mutual fund shares and the mutual fund's shares were originally available to the public but are unavailable to the public when the contract holder's premiums are invested, then the contract holder is not treated as the owner of the mutual fund shares.

In *Christofferson v. United States*, 749 F.2d 513 (8th Cir. 1984), an individual purchased a purported deferred "annuity" contract that permitted the contract holder to allocate the consideration paid for the contract among various mutual funds. The contract holder could reallocate funds among the mutual funds at any time, and could withdraw part or all of the funds with seven days notice. The contract also gave the contract holder an option to purchase an immediate life annuity at guaranteed rates. The contract holder did not have to exercise the option. The court found that the contract holder had surrendered few of the rights of ownership or control over the assets, and therefore con-

cluded that the contract holder was the owner of the mutual fund shares for tax purposes. As the contract holder could surrender the contract for cash prior to annuitization, the possibility that the mutual fund shares could be converted into an immediate annuity at rates guaranteed in the contract did not cause the contract holder to lack ownership or control.

Section 817(h) of the Internal Revenue Code was added by §211(a) of the Tax Reform Act of 1984, 1984–3 (Vol. 1) C.B. 259–60, effective for taxable years beginning after December 31, 1983. Section 817(h) provides that a variable contract (other than a pension plan contract described in § 818(a)) is not treated as a life insurance, endowment, or annuity contract if the investments of a segregated asset account upon which the contract is based are not adequately diversified in accordance with regulations prescribed by the Secretary. Pension plan contracts described in § 818(a) are subject to a variety of statutory limits, including limits on annual contributions, that do not apply to other variable contracts.

The legislative history explains the purpose underlying the § 817(h) diversification requirement as follows:

> In authorizing Treasury to prescribe diversification standards, the conferees intend that standards be designed to deny annuity or life insurance treatment for investments that are publicly available to investors and investments that are made, in effect, at the direction of the investor.

H.R. Conf. Rep. No. 861, 98th Cong., 2d Sess. 1055, 1984–3 (Vol. 2) C.B. 309.

Section 1.817–5 of the Income Tax Regulations provides guidance related to the minimum level of diversification applicable to the investments underlying variable annuity and life insurance contracts. Satisfying the diversification requirements, however, does not prevent a contract holder's control of the investments of a segregated asset account from causing the contract holder, rather than the insurance company, to be treated as the owner of the assets in the account.

SECTION 3. SCOPE

This revenue procedure applies to a contract that otherwise would qualify as an annuity contract for purposes of §§ 403(a) or 403(b), or as an individual retirement annuity for purposes of § 408(b), but for the fact that contract premiums are invested at the direction of the contract holder in publicly available securities.

SECTION 4. APPLICATION

Notwithstanding that contract premiums are invested at the contract holder's direction in publicly available securities, the Service will treat a contract described in section 3 of this revenue procedure as an annuity contract and will not treat the contract holder as owning the assets associated with the contract, provided the following conditions are met:

1. For a contract that is intended to qualify as an annuity contract for purposes of §§ 403(a) or 403(b), no additional federal tax liability would have been incurred if the employer of the contract holder had instead paid an amount into a trust or a custodial account in an arrangement that satisfied the requirements of §§ 401(a) or 403(b)(7)(A), respectively; or

2. For a contract that is intended to qualify as an individual retirement annuity for purposes of § 408(b), no additional federal tax liability would have been incurred if consideration for the contract had instead been held as part of a trust that would satisfy the requirements of § 408(a), except that the general account of an insurance company shall be treated as a common investment fund for purposes of satisfying § 408(a)(5).

EFFECTIVE DATE

This revenue procedure is effective on November 16,1999, with respect to all taxable years.

Under the authority of § 7805(b) of the Code, this revenue procedure will not be applied adversely to an issuer or holder of a contract issued before November 16, 1999.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 81–225 is modified.

DRAFTING INFORMATION

The principal author of this revenue procedure is Katherine Hossofsky of the Office of Assistant Chief Counsel (Financial Institutions & Products). For further information regarding this revenue procedure, contract Ms. Hossofsky on (202) 622-3477 (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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