Internal Revenue
bulletin

Bulletin No. 1999–51
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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 99–54, page 675.

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period October through December 1999. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 1999.

Rev. Rul. 99–55, page 675.

LIFO; price indexes; department stores. The October 1999 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, October 31, 1999.

Rev. Rul. 99–56, page 676.

Timber casualty losses. The decisions in *Westvaco Corp. v. United States* and *Weyerhaueser v. United States* pertain to single, identifiable property (SIP) in relation to casualty losses. Rev. Ruls. 66–9 and 73–51 revoked.

Rev. Rul. 99–57, page 678.

Applying section 1032 to partnership transaction. This ruling explains the tax consequences to a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction.

Notice 99–57, page 692.

Guidance is provided under section 705 of the Code relating to certain situations where gain or loss may be improperly created by adjusting the basis of a partnership interest for partnership income that is not subject to tax, or for partnership losses or deductions that are permanently denied, with respect to a partner.

Notice 99–58, page 693.

Authorized IRS *e-file* providers, Form 1040 on-line transmitters, and financial institutions may apply to obtain a Debt Indicator for their customer/client taxpayers in exchange for screening individual income tax returns for potential abuse and reporting the findings to the IRS.

ESTATE TAX

T.D. 8846, page 679.

Final regulations under sections 2055 and 2056 of the Code relate to the effect of certain Administration expenses on the valuation of property that qualifies for the estate tax charitable or marital deduction. Rev. Ruls. 66–233, 73–98, 80–159, 93–48 obsoleted.

GIFT TAX

T.D. 8845, page 683.

Final regulations under sections 2001, 2504, and 6501(c) of the Code relate to the valuation of prior gifts in determining estate and gift tax liability, and to the commencement of the period of limitations for assessing and collecting gift tax.

Finding Lists begin on page ii.
Announcement of Declatory Judgement Proceedings Under Section 7428 on page 699.

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.

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

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

Section 42.—Low-Income Housing Credit

Low-income housing credit; satisfactory bond; "bond factor" amounts for the period October through December 1999. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period October through December 1999.

Rev. Rul. 99–54

In Rev. Rul. 90–60, 1990–2 C.B. 3, the Internal Revenue Service provided guidance to taxpayers concerning the general methodology used by the Treasury Department in computing the bond factor amounts used in calculating the amount of bond considered satisfactory by the Secretary under § 42(j)(6) of the Internal Revenue Code. It further announced that the Secretary would publish in the Internal Revenue Bulletin a table of "bond factor" amounts for dispositions occurring during each calendar month.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) for dispositions of qualified low-income buildings or interests therein during the period October through December 1999, and includes bond factor amounts previously published for dispositions occurring during the period January through September 1999.

Table 1
Rev. Rul. 99–54

Monthly Bond Factor Amounts for Dispositions Expressed As a Percentage of Total Credits

	Calendar Year Building Placed in Service or, if Section 42(f)(1) Election Was Made, the Succeeding Calendar Year												
Month of Disposition	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Jan '99	44.10	57.48	70.98	72.56	74.67	77.09	79.54	81.87	84.18	86.70	89.33	92.33	92.81
Feb '99	44.10	57.48	70.98	72.35	74.45	76.85	79.29	81.60	83.90	86.40	89.00	91.92	92.81
Mar '99	44.10	57.48	70.98	72.14	74.24	76.62	79.05	81.35	83.63	86.11	88.69	91.56	92.81
Apr '99	45.71	60.18	75.06	76.82	79.83	83.22	86.70	90.11	93.55	97.27	101.15	105.33	107.43
May '99	45.71	60.18	75.06	76.60	79.60	82.97	86.44	89.83	93.26	96.96	100.81	104.97	107.43
Jun '99	45.71	60.18	75.06	76.39	79.38	82.73	86.18	89.56	92.97	96.66	100.51	104.65	107.43
Jul '99	45.71	60.18	75.06	76.18	79.16	82.50	85.93	89.30	92.70	96.38	100.22	104.36	107.43
Aug '99	45.71	60.18	75.06	75.97	78.94	82.27	85.69	89.04	92.44	96.11	99.95	104.10	107.43
Sep '99	45.71	60.18	75.06	75.77	78.73	82.05	85.45	88.80	92.19	95.85	99.69	103.86	107.43
Oct '99	45.71	60.18	75.06	75.57	78.52	81.83	85.22	88.56	91.94	95.60	99.45	103.65	107.43
Nov '99	45.71	60.18	75.06	75.37	78.32	81.61	85.00	88.32	91.71	95.37	99.23	103.46	107.43
Dec '99	45.71	60.18	75.06	75.18	78.12	81.40	84.78	88.10	91.48	95.14	99.01	103.28	107.43

For a list of bond factor amounts applicable to dispositions occurring during other calendar years, see the following revenue rulings: Rev. Rul.98–3, 1998–2 I.R.B. 4, for dispositions occurring during the calendar years 1996 and 1997; Rev. Rul. 98–13, 1998–11 I.R.B. 4, for dispositions occurring during the period January through March 1998; Rev. Rul. 98–31, 1998–25 I.R.B. 4, for dispositions occurring during the period April through June 1998; Rev. Rul. 98–45, 1998–38 I.R.B. 4, for dispositions occurring during the period July through September 1998; and Rev. Rul. 99–1, 1999–2 I.R.B. 4, for dispositions occurring during the period October through December 1998.

DRAFTING INFORMATION

The principal author of this revenue ruling is Gregory N. Doran of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Mr. Doran on (202) 622-3040 (not a toll-free call).

Section 165.—Losses

26 CFR 1.165–7: Casualty losses.

If a taxpayer suffers a timber casualty loss, what is the single, identifiable property that the taxpayer will use to compute the amount of the casualty loss? See Rev. Rul. 99–56, page 676.

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

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

LIFO; price indexes; department stores. The October 1999 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, October 31, 1999.

Rev. Rul. 99–55

The following Department Store Inventory Price Indexes for October 1999 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, October 31, 1999.

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	Oct. 1998	Oct. 1999	Percent Change from Oct. 1998 to Oct. 1999[1]
1. Piece Goods	548.9	545.8	-0.6
2. Domestics and Draperies	637.5	625.6	-1.9
3. Women's and Children's Shoes	679.2	653.3	-3.8
4. Men's Shoes	921.6	881.2	-4.4
5. Infants' Wear	640.2	645.2	0.8
6. Women's Underwear	572.6	571.7	-0.2
7. Women's Hosiery	308.9	328.9	6.5
8. Women's and Girls' Accessories	551.6	536.7	-2.7
9. Women's Outerwear and Girls' Wear	423.5	416.9	-1.6
10. Men's Clothing	620.1	627.5	1.2
11. Men's Furnishings	607.8	631.1	3.8
12. Boys' Clothing and Furnishings	521.0	508.8	-2.3
13. Jewelry	982.7	969.2	-1.4
14. Notions	757.6	771.7	1.9
15. Toilet Articles and Drugs	946.4	985.6	4.1
16. Furniture and Bedding	673.7	692.3	2.8
17. Floor Coverings	601.0	603.3	0.4
18. Housewares	817.1	792.9	-3.0
19. Major Appliances	238.3	234.8	-1.5
20. Radio and Television	70.6	64.2	-9.1
21. Recreation and Education[2]	102.8	96.5	-6.1
22. Home Improvements[2]	129.5	128.8	-0.5
23. Auto Accessories[2]	107.9	106.8	-1.0
Groups 1 - 15: Soft Goods	612.7	612.3	-0.1
Groups 16 - 20: Durable Goods	460.5	448.6	-2.6
Groups 21 - 23: Misc. Goods[2]	107.3	102.7	-4.3
Store Total[3]	556.9	550.9	-1.1

[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 Alan J. Tomsic of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Tomsic on (202) 622-4970 (not a toll-free call).

Section 611.—Allowance of Deduction for Depletion

26 CFR 1.611–3: Rules applicable to timber. (Also, section 165; 1.165–7.)

Timber casualty losses. The decisions in *Westvaco Corp. v. United States* and *Weyerhaueser v. United States* pertain to single, identifiable property (SIP) in relation to casualty losses. Rev. Ruls. 66–9 and 73–51 revoked.

Rev. Rul. 99–56

ISSUE

The Internal Revenue Service has reconsidered Rev. Rul. 66–9, 1966–1 C.B. 39, and Rev. Rul. 73–51, 1973–1 C.B. 75,

in light of the decisions in *Westvaco Corp. v. United States*, 639 F.2d 700 (Ct. Cl. 1980), and *Weyerhaeuser v. United States*, 92 F.3d 1148 (1996), *rev'g in part and aff'g in part*, 32 Fed. Cl. 80 (1994), *cert. denied*, 519 U.S. 1091 (1997).

LAW AND ANALYSIS

Section 1.165–7(b)(2) of the Income Tax Regulations provides that a casualty loss must be determined by reference to a single, identifiable property (SIP) damaged or destroyed by casualty. Rev. Rul. 66–9 holds that, in the case of a casualty loss to timber, the SIP damaged or destroyed by casualty is the quantity of timber—the units (board feet, log scale, cords, or other units) of wood in standing trees that are available and suitable for exploitation and use by forest industries—rendered unfit for use by casualty (in that case, a hurricane). Rev. Rul. 66–9 articulates two interrelated concepts. One is the definition of SIP; the other is the sufficiency of damage giving rise to a casualty loss. It defines SIP to be the quantity of timber destroyed by the casualty. It regards only total destruction of the timber to be legally sufficient to trigger a casualty loss. The revenue ruling holds that the loss from the sale or other disposition of the timber that was not destroyed by the hurricane should be determined at the time of sale or other disposition by subtracting the adjusted basis of the quantity of timber disposed of from the amount received for that timber.

Rev. Rul. 73–51, in considering the allowance of a section 165 casualty loss on account of an ice storm, repeats the SIP definition of Rev. Rul. 66–9 and holds that the physical damage (in that case, broken crowns or root damage that stunted tree growth) to the merchantable trees did not result in any of the existing timber being rendered unfit for use.

The Court of Claims, in *Westvaco*, decided that the SIP damaged or destroyed by storms and fires included all of the taxpayer's standing timber in the district (block) directly affected by each casualty and not just the units of timber contained in the trees suffering mortal injury. The court enunciated the standard that the appropriate SIP is any unit of property that has an identifiable adjusted basis and that is reasonable and logical and identifiable in relation to the area affected by the casualty. The court also held that the allowable loss for casualty is not limited to merchantable units of timber totally destroyed.

In Weyerhaeuser, the United States Court of Appeals for the Federal Circuit held that the SIP damaged or destroyed by several forest fires and a volcanic eruption affecting taxpayer's timber property was the block, that subdivision of a taxpayer's forest holdings selected by the taxpayer as a means of tracking the adjusted basis in the timber pursuant to section 1.611–(3)(d)(1). Consistent with *Westvaco*, a casualty loss was allowed for trees that were damaged but not rendered worthless.

HOLDING

In light of the court decisions in *Westvaco* and *Weyerhaeuser* the Service is revoking Rev. Rul. 66–9 and Rev. Rul. 73–51.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 66–9, 1966–1 C.B. 39, and Rev. Rul. 73–51, 1973–1 C.B. 75, are revoked.

DRAFTING INFORMATION

The principal author of this revenue ruling is Richard T. Probst of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Richard T. Probst on (202) 622-3120 (not a toll-free call).

Section 701.—Partners, not Partnership, Subject to Tax

26 CFR 1.701–2: Anti-abuse rule.

Is the partnership viewed as an entity or as an aggregate of its partners when determining whether a corporate partner must recognize any gain or loss that the partnership allocates to it upon the sale or exchange in a taxable transaction of the partner's stock contributed by the partner to the partnership? See Rev. Rul. 99–57, page 678.

Section 704.—Partner's Distributive Share

26 CFR 1.704.3: Contributed property.

What is a partner's correct amount of gain or loss from a partnership's sale or exchange in a taxable transaction of stock in the partner contributed to the partnership by the partner? See Rev. Rul. 99–57, page 678.

Section 705.—Determination of Basis of Partner's Interest

What basis adjustment should be made to reflect that amount of gain or loss allocated to a partner that contributes its own stock to a partnership upon the partnership's sale or exchange in a taxable transaction of that stock when the partner may not recognize that gain or loss under § 1032 of the Internal Revenue Code? See Rev. Rul. 99–57, page 678.

Section 721.—Nonrecognition of Gain or Loss on Contribution

Does a partner that contributes shares of its own stock to a partnership in exchange for a partnership interest recognize gain or loss on that contribution? See Rev. Rul. 99–57, page 678.

Section 722.—Basis of Contributing Partner's Interest

What basis does a partner that contributes shares of its own stock to a partnership in exchange for a partnership interest have in its partnership interest? See Rev. Rul. 99–57, page 678.

Section 723.—Basis of Property Contributed to Partnership

What basis does a partnership have in the stock of one of its partners contributed by that partner in exchange for a partnership interest? See Rev. Rul. 99–57, page 678.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

What is a partnership's amount of gain or loss on the sale or exchange in a taxable transaction of stock of one of its partners contributed to the partnership by that partner? See Rev. Rul. 99–57, on this page.

Section 1011.—Adjusted Basis for Determining Loss

What is a partnership's basis in the stock of one of its partners contributed to the partnership by that partner when computing the amount of gain or loss on the sale or exchange in taxable transaction of that stock? See Rev. Rul. 99–57, on this page .

Section 1032.—Exchange of Stock For Property

26 CFR 1.1032–1: Disposition by a corporation of its own capital stock. (Also, sections 701, 704, 705, 721, 722, 723, 1001, 1011; 1.701–2(e), 1.704–3.)

Applying section 1032 to partnership transaction. This ruling explains the tax consequences to a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction.

Rev. Rul. 99–57

ISSUE

What are the tax consequences to a partnership and a corporate partner where the corporate partner contributes its own stock to the partnership, and the partnership later exchanges the stock with a third party in a taxable transaction?

FACTS

A, a corporation taxed under subchapter C of the Internal Revenue Code, and B, an individual, form AB partnership for bona fide business purposes. A contributes 100 shares of its own stock, valued at $100x, with a basis of zero, to AB in exchange for a 50 percent partnership interest. B contributes a parcel of real property with a value and adjusted basis equal to $100x in exchange for a 50 percent partnership interest. Under the partnership agreement, A and B each will be allocated a 50 percent share of all partnership items. One year later, after the value of the stock has increased to $120x, AB purchases property valued at $60x from C in exchange for 50 shares of A stock and transfers 50 shares of A stock to D in exchange for services valued at $60x.

LAW

Section 701 states that the partners in a partnership, and not the partnership, are liable for the income tax imposed by Chapter 1.

Sections 702(a)(1) and 702(a)(2) provide that in determining the partners' income tax, each partner shall take into account separately the partner's distributive share of partnership gains or losses from sales or exchanges of capital assets.

Section 704(b) provides that a partner's distributive share of income, gain, loss, deduction, or credit (or item thereof) is determined in accordance with the partner's interest in the partnership (determined by taking into account all facts and circumstances), if (1) the partnership agreement does not provide as to the partner's distributive share of income, gain, loss, deduction, or credit (or item thereof), or (2) the allocation to a partner under the agreement of income, gain, loss, deduction, or credit (or item thereof) does not have substantial economic effect.

Section 704(c)(1)(A) provides that income, gain, loss, and deduction with respect to property contributed to a partnership by a partner is shared among the partners so as to take account of the variation between the basis of the property to the partnership and its fair market value at the time of contribution (the built-in gain or loss).

Section 1.704–3(a)(3) of the Income Tax Regulations defines § 704(c) property as property contributed to a partnership if, at the time of contribution, its book value differs from the contributing partner's adjusted tax basis. Book value is equal to the fair market value of the property at the time of contribution.

Section 705(a)(1) provides that the adjusted basis of a partner's interest in a partnership shall be increased by the sum of the partner's distributive share for the taxable year and prior taxable years of: (A) taxable income of the partnership as determined under § 703(a), (B) income of the partnership exempt from income tax, and (C) the excess of the deductions for depletion over the basis of the property subject to depletion.

Section 721(a) provides a general nonrecognition rule for a partner's contributions of property to a partnership in exchange for a partnership interest. The rule is subject to a limited exception in § 721(b).

Section 722 provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership shall be the amount of the money and the adjusted basis of the property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized under § 721(b) to the contributing partner at the time.

Section 723 states that the basis of property contributed to a partnership is the adjusted basis of the property to the partner at the time of contribution increased by the amount (if any) of gain recognized by the contributing partner under § 721(b).

Section 1001 provides that the gain from the sale or other disposition of property shall be the excess of the amount realized over the adjusted basis provided in § 1011. The amount realized from the sale or other disposition of property shall be the sum of any money received plus the fair market value of property (other than money) received.

Section 1011 provides that the adjusted basis for determining gain or loss from the sale or other disposition of property by a partnership, whenever acquired, shall be the basis determined under § 1012 and other applicable sections of subchapters O and K.

Section 1032(a) states that a corporation does not recognize gain or loss on the receipt of money or other property in exchange for the corporation's stock. Prior to the enactment of § 1032, a corporation potentially could recognize gain or loss by purchasing and reselling its own shares, even though it would not have recognized gain or loss on the disposition of newly issued shares. This disparity, which gave rise to tax avoidance opportu-

nities through selective loss recognition, was eliminated by Congress with the enactment of § 1032. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A268 (1954).

Section 1.1032–1(a) provides that a transfer by a corporation of shares of its own stock as compensation for services is considered, for purposes of § 1032(a), as a disposition by the corporation of the shares for money or other property.

Rev. Rul. 74–503, 1974–2 C.B. 117, considers the tax consequences of a parent corporation's transfer to its subsidiary of its own treasury stock in a transaction to which § 351 applies. The ruling holds that, under certain circumstances, the basis of the parent corporation's treasury stock in the hands of the parent corporation is zero. Accordingly, under the transferred basis rule of § 362(a), the subsidiary corporation's basis of the treasury stock of the parent corporation is also zero.

Partnership taxation is a mixture of provisions that treat the partnership as an aggregate of its members or as a separate entity. Under the aggregate approach, each partner is treated as the owner of an undivided interest in partnership assets and operations. Under the entity approach, the partnership is treated as a separate entity in which partners have no direct interest in partnership assets and operations. In enacting subchapter K, Congress indicated that aggregate, rather than entity, concepts should be applied if the concepts are more appropriate in applying other provisions of the Code. S.Rep. No. 1622, 83d Cong., 2d Sess. 89 (1954) and H.R. Conf. Rep. No. 2543, 83d Cong., 2d Sess. 59 (1954); *See also* Treas. Reg. § 1.701–2(e) (1994).

ANALYSIS

When *A* contributes its own stock to *AB*, no gain or loss is recognized to *A* or *AB* under § 721(a). *AB*'s basis in the stock is zero under § 723, and *A*'s basis in its partnership interest in *AB* is zero under § 722. *Cf.* Rev. Rul. 74–503, 1974–2 C.B. 117. When *AB* subsequently purchases property from *C* in exchange for *A* stock and pays *A* stock to *D* in exchange for services, there is a realization of gain by *AB* measured by the difference between the basis of the stock and the value of the property and services received. *AB* realizes $120x of gain ($60x on the exchange of stock for property and $60x on the payment of stock for services). *AB* allocates $100x of gain to *A* under § 704(c), and allocates the remaining $20x pursuant to the partnership agreement, $10x each to *A* and *B*.

If *A*'s share of the gain from the use of its stock in these transactions was not subject to § 1032, *A* would recognize $110x of gain. Section 1032 is intended to prevent a corporation from recognizing gain or loss when dealing in its own stock. Under § 704(b) and 704(c), a corporate partner contributing its own stock generally will be allocated an amount of gain attributable to its stock that corresponds to its economic interest in the stock held by the partnership. Accordingly, use of the aggregate theory of partnerships is appropriate in determining the application of § 1032 with respect to gain allocated to a corporate partner. Under § 1032, *A*'s share of the gain resulting from *AB*'s exchange of *A* stock will not be subject to tax. In addition, *A* increases its basis in its partnership interest in *AB* under § 705 by $110x, the amount equal to *A*'s share of the gain resulting from *AB*'s exchange of *A* stock, thereby preserving the nonrecognition result of the transaction in accordance with the policy underlying § 1032.

Furthermore, in keeping with the nonrecognition policy underlying § 1032, an analysis similar to that described above would apply to a transaction in which a corporate partner is allocated a loss from a transaction involving the disposition of stock of the corporate partner held by the partnership.

HOLDING

If a corporate partner contributes its own stock to a partnership in exchange for a partnership interest, and the partnership later exchanges the stock in a taxable transaction, then the partnership will realize gain that will be allocated to the partners under § 704. Under § 1032, however, the corporate partner will not recognize the gain allocated to it with respect to the sale or exchange of the stock. Furthermore, under § 705, the corporate partner increases its basis in its partnership interest by an amount equal to its share of the gain resulting from the partnership's sale or exchange of the stock.

DRAFTING INFORMATION

The principal author of this revenue ruling is Robert Honigman of the Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this revenue ruling contact Robert Honigman at (202) 622-3050 (not a toll-free call).

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(b)–4: Marital deduction; valuation of interest passing to surviving spouse.

T.D. 8846

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 20

Deductions for Transfers for Public, Charitable, and Religious Uses; In General

Marital Deduction; Valuation of Interest Passing to Surviving Spouse

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the effect of certain administration expenses on the valuation of property that qualifies for either the estate tax marital deduction under section 2056 of the Internal Revenue Code or the estate tax charitable deduction under section 2055. The regulations distinguish between estate transmission expenses, which reduce the value of property for marital and charitable deduction purposes, and estate management expenses, which generally do not reduce the value of property for these purposes.

EFFECTIVE DATES: These regulations are effective on December 3, 1999.

FOR FURTHER INFORMATION CONTACT: Deborah Ryan, (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 16, 1998, the Treasury Department and the IRS published in the **Federal Register** (63 FR 69248) a notice of proposed rulemaking (REG–114663–97, 1999-6 I.R.B. 15) relating to the effect of certain administration expenses on the valuation of property which qualifies for the estate tax marital or charitable deduction. The proposed regulations were issued in response to the decision of the Supreme Court of the United States in *Commissioner v. Estate of Hubert*, 520 U.S. 93 (1997) (1997–2 C.B. 231). Written comments responding to the notice of proposed rulemaking were received, and a public hearing was held on April 21, 1999, at which time oral testimony was presented. This Treasury decision adopts final regulations with respect to the notice of proposed rulemaking. A summary of the principal comments received and revisions made in response to those comments is provided below.

The proposed regulations set forth the substantive provisions as applied to the estate tax marital deduction in §20.2056(b)–4(a). For the estate tax charitable deduction, the proposed regulations (under §20.2055–1(d)(6)) merely cross-reference the rules for the marital deduction.

Several commentators suggested that the regulations under section 2055 should contain specific rules relating to the charitable deduction, rather than just a cross-reference. The Treasury and the IRS agree with this suggestion. The final regulations contain rules under §20.2055–3 specifically addressing the effect of administration expenses on the valuation of property when all or a portion of the interests in property qualify for the estate tax charitable deduction.

Several commentators stated that the distinction between estate transmission expenses and estate management expenses was not clearly made in the proposed regulations and requested more concrete definitions of each type of expense. In response to these comments, the final regulations characterize estate transmission expenses as those expenses that would not have been incurred except for the decedent's death. Although the amount of these expenses cannot be calculated with any degree of certainty on the date of the decedent's death, they are expenses that are incurred because of the decedent's death. Estate management expenses, on the other hand, are characterized in the final regulations as expenses that would be incurred with respect to the property even if the decedent had not died; that is, expenses incurred in investing, maintaining, and preserving the property. These are expenses that typically would have been incurred with respect to the property by the decedent before death or by the beneficiaries had they received the property on the date of death without any intervening period of administration. In order to be certain that all expenses are classified as either transmission expenses or management expenses, transmission expenses are defined to include all expenses that are not management expenses.

Three commentators stated that the different treatment accorded to estate transmission expenses and estate management expenses under the proposed regulations creates a new federal standard for allocating expenses that may be contrary to the manner in which the expenses must be charged under state law. However, the Treasury and the IRS believe that the allocation of administration expenses based on the distinction between transmission and management expenses provides the most accurate measure of the value of the property which passes to the surviving spouse or to the charity at the moment of the decedent's death for federal estate tax marital and charitable deduction purposes. Transmission expenses that are charged to the property passing to the surviving spouse or to the charity reduce the amount of that property as of the date of the decedent's death because the expenses, as well as the transfer to the surviving spouse or to charity, are a consequence of, and arise as a result of, the decedent's death. In contrast, management expenses do not generally reduce the amount of the property passing from the decedent as of the date of the decedent's death because these expenses are incurred in producing income and preserving and maintaining the property between the date of the decedent's death and the date of distribution. These expenses are the ongoing, year-to-year expenses incurred in the investment, preservation, and maintenance of property by property owners.

In response to other comments, the final regulations illustrate the application of these rules to pecuniary bequests to the surviving spouse. If, under the terms of the governing instrument or applicable local law, the recipient of a pecuniary bequest is not entitled to income earned until distribution, the income is not included in the definition of the marital or charitable share. Thus, the amount of the property passing to the surviving spouse or charity for which a marital or charitable deduction is allowable will not be reduced even if estate transmission or estate management expenses are paid out of the income earned by assets that will be used to satisfy the pecuniary bequest.

Two commentators requested guidance in applying the regulations to estates that are intended to be nontaxable. Accordingly, the final regulations add two examples, one involving a formula designed to produce zero estate taxes and the other involving a pecuniary bequest designed to utilize the applicable exclusion amount under section 2010.

Many of the comments concerned the special rule of §20.2056(b)–4(e)(2)(ii) of the proposed regulations. Under the special rule, the value of the deductible property interest is not increased as a result of the decrease in the federal estate tax liability that is attributable to the deduction of estate management expenses as expenses ofadministration under section 2053 on the federal estate tax return. A similar rule would have applied for purposes of the estate tax charitable deduction.

Several of these commentators argued that the special rule is inconsistent with sections 2056(a) and 2055(c), because the value of the property passing to the surviving spouse or charity should be reduced only by the estate taxes actually paid. Thus, an estate should be permitted the full benefit of deducting management expenses on the federal estate tax return, including an increase to the marital or charitable deduction based on the resultant decrease in tax payable from the marital or charitable share.

Conversely, other commentators asserted that the special rule does not conform with section 2056(b)(9). Section 2056(b)(9) provides that nothing in section 2056 or any other estate tax provision shall allow the value of any interest in property to be deducted for federal estate tax purposes more than once with respect to the same decedent. These commentators pointed out that if estate management expenses paid from the marital or charitable share are deducted on the federal estate tax return, and no reduction is made to the allowable amount of the marital or charitable deduction, then the same property interest is deducted twice in violation of section 2056(b)(9).

After considering these comments, the Treasury and the IRS have eliminated the special rule of the proposed regulations. The final regulations provide that estate management expenses attributable to, and payable from, the property interest passing to the surviving spouse or charity do not reduce the value of the property interest. However, pursuant to section 2056(b)(9), the allowable amount of the marital or charitable deduction is reduced by the amount of these management expenses if they are deducted on the Federal estate tax return.

The Treasury and the IRS believe that the principles which apply for determining the value of the marital and charitable deductions should also apply for determining the value of property that passes from one decedent to another when calculating the amount of the credit for tax on prior transfers under section 2013. Therefore, the final regulations amend §20.2013–4(b) by adding a cross reference to §20.2056(b)–4(d).

Effective Dates

The regulations under sections 2055 and 2056 are applicable to estates of decedents dying on or after December 3, 1999. The regulations under section 2013 are applicable to transfers from estates of decedents dying on or after December 3, 1999.

Effect on Other Documents

The following publications are obsolete as of December 3, 1999:
Rev. Rul. 66–233 (1996–2 C.B. 428)
Rev. Rul. 73–98 (1973–1 C.B. 407)
Rev. Rul. 80–159 (1980–1 C.B. 206)
Rev. Rul. 93–48 (1993–2 C.B. 270)

Special Analyses

This rule is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the 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, these regulations were submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Deborah Ryan, Office of the Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

Accordingly, 26 CFR part 20 is amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2013–4 is amended by:

1. Removing "and" at the end of paragraph (b)(2).

2. Redesignating paragraph (b)(3) as paragraph (b)(4).

3. Adding a new paragraph (b)(3).

The addition reads as follows:

§20.2013–4 Valuation of property transferred.

* * * * *

(b) * * *

(3)(i) By the amount of administration expenses in accordance with the principles of §20.2056(b)–4(d).

(ii) This paragraph (b)(3) applies to transfers from estates of decedents dying on or after December 3, 1999; and

* * * * *

Par. 3. Section 20.2055–3 is amended by:

1. Revising the section heading.

2. Adding a paragraph heading for paragraph (a).

3. Redesignating the text of paragraph (a) following the heading and paragraphs (b) and (c) as paragraph (a)(1), and paragraphs (a)(2) and (a)(3), respectively.

4. Adding a new paragraph (b).

The revision and additions read as follows:

§20.2055–3 Effect of death taxes and administration expenses.

(a) *Death taxes.* * * *

(b) *Administration expenses*—(1) *Definitions*—(i) *Management expenses*. Estate management expenses are expenses that are incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration. Examples of these expenses could include investment advisory fees, stock brokerage commissions, custodial fees, and interest.

(ii) *Transmission expenses*. Estate transmission expenses are expenses that would not have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes, and distributing the decedent's property to those who are entitled to receive it. Estate transmission expenses include any administration expense that is not a management expense. Examples of these expenses could include executor commissions and attorney fees (except to the extent of commissions or fees specifically related to investment, preservation, and maintenance of the assets), probate fees, expenses incurred in construction proceedings and defending against will contests, and appraisal fees.

(iii) *Charitable share*. The charitable share is the property or interest in property that passed from the decedent for which a deduction is allowable under section 2055(a) with respect to all or part of the property interest. The charitable share includes, for example, bequests to charitable organizations and bequests to a charitable lead unitrust or annuity trust, a charitable remainder unitrust or annuity trust,

and a pooled income fund, described in section 2055(e)(2). The charitable share also includes the income produced by the property or interest in property during the period of administration if the income, under the terms of the governing instrument or applicable local law, is payable to the charitable organization or is to be added to the principal of the property interest passing in whole or in part to the charitable organization.

(2) *Effect of transmission expenses.* For purposes of determining the charitable deduction, the value of the charitable share shall be reduced by the amount of the estate transmission expenses paid from the charitable share.

(3) *Effect of management expenses attributable to the charitable share.* For purposes of determining the charitable deduction, the value of the charitable share shall not be reduced by the amount of the estate management expenses attributable to and paid from the charitable share. Pursuant to section 2056(b)(9), however, the amount of the allowable charitable deduction shall be reduced by the amount of any such management expenses that are deducted under section 2053 on the decedent's federal estate tax return.

(4) *Effect of management expenses not attributable to the charitable share.* For purposes of determining the charitable deduction, the value of the charitable share shall be reduced by the amount of the estate management expenses paid from the charitable share but attributable to a property interest not included in the charitable share.

(5) *Example.* The following example illustrates the application of this paragraph (b):

Example. The decedent, who dies in 2000, leaves his residuary estate, after the payment of debts, expenses, and estate taxes, to a charitable remainder unitrust that satisfies the requirements of section 664(d). During the period of administration, the estate incurs estate transmission expenses of $400,000. The residue of the estate (the charitable share) must be reduced by the $400,000 of transmission expenses and by the Federal and State estate taxes before the present value of the remainder interest passing to charity can be determined in accordance with the provisions of §1.664–4 of this chapter. Because the estate taxes are payable out of the residue, the computation of the estate taxes and the allowable charitable deduction are interrelated. See paragraph (a)(2) of this section.

(6) *Cross reference.* See §20.2056(b)–4(d) for additional examples applicable to the treatment of administration expenses under this paragraph (b).

(7) *Effective date.* The provisions of this paragraph (b) apply to estates of decedents dying on or after December 3, 1999.

Par. 4. Section 20.2056(b)–4 is amended by:

1. Removing the last two sentences of paragraph (a).

2. Redesignating paragraph (d) as paragraph (e).

3. Adding a new paragraph (d).

The addition reads as follows:

§20.2056(b)–4 Marital deduction; valuation of interest passing to surviving spouse.

* * * * *

(d) *Effect of administration expenses*—(1) *Definitions*—(i) *Management expenses.* Estate management expenses are expenses that are incurred in connection with the investment of estate assets or with their preservation or maintenance during a reasonable period of administration. Examples of these expenses could include investment advisory fees, stock brokerage commissions, custodial fees, and interest.

(ii) *Transmission expenses.* Estate transmission expenses are expenses that would not have been incurred but for the decedent's death and the consequent necessity of collecting the decedent's assets, paying the decedent's debts and death taxes, and distributing the decedent's property to those who are entitled to receive it. Estate transmission expenses include any administration expense that is not a management expense. Examples of these expenses could include executor commissions and attorney fees (except to the extent of commissions or fees specifically related to investment, preservation, and maintenance of the assets), probate fees, expenses incurred in construction proceedings and defending against will contests, and appraisal fees.

(iii) *Marital share.* The marital share is the property or interest in property that passed from the decedent for which a deduction is allowable under section 2056(a). The marital share includes the income produced by the property or interest in property during the period of administration if the income, under the terms of the governing instrument or applicable local law, is payable to the surviving spouse or is to be added to the principal of the property interest passing to, or for the benefit of, the surviving spouse.

(2) *Effect of transmission expenses.* For purposes of determining the marital deduction, the value of the marital share shall be reduced by the amount of the estate transmission expenses paid from the marital share.

(3) *Effect of management expenses attributable to the marital share.* For purposes of determining the marital deduction, the value of the marital share shall not be reduced by the amount of the estate management expenses attributable to and paid from the marital share. Pursuant to section 2056(b)(9), however, the amount of the allowable marital deduction shall be reduced by the amount of any such management expenses that are deducted under section 2053 on the decedent's Federal estate tax return.

(4) *Effect of management expenses not attributable to the marital share.* For purposes of determining the marital deduction, the value of the marital share shall be reduced by the amount of the estate management expenses paid from the marital share but attributable to a property interest not included in the marital share.

(5) *Examples.* The following examples illustrate the application of this paragraph (d):

Example 1. The decedent dies after 2006 having made no lifetime gifts. The decedent makes a bequest of shares of ABC Corporation stock to the decedent's child. The bequest provides that the child is to receive the income from the shares from the date of the decedent's death. The value of the bequeathed shares on the decedent's date of death is $3,000,000. The residue of the estate is bequeathed to a trust for which the executor properly makes an election under section 2056(b)(7) to treat as qualified terminable interest property. The value of the residue on the decedent's date of death, before the payment of administration expenses and Federal and State estate taxes, is $6,000,000. Under applicable local law, the executor has the discretion to pay administration expenses from the income or principal of the residuary estate. All estate taxes are to be paid from the residue. The State estate tax equals the State death tax credit available under section 2011. During the period of administration, the estate incurs estate transmission expenses of $400,000, which the executor charges to the residue. For purposes of determining the marital deduction, the value of the

residue is reduced by the Federal and State estate taxes and by the estate transmission expenses. If the transmission expenses are deducted on the Federal estate tax return, the marital deduction is $3,500,000 ($6,000,000 minus $400,000 transmission expenses and minus $2,100,000 Federal and State estate taxes). If the transmission expenses are deducted on the estate's Federal income tax return rather than on the estate tax return, the marital deduction is $3,011,111 ($6,000,000 minus $400,000 transmission expenses and minus $2,588,889 Federal and State estate taxes).

Example 2. The facts are the same as in *Example 1*, except that, instead of incurring estate transmission expenses, the estate incurs estate management expenses of $400,000 in connection with the residue property passing for the benefit of the spouse. The executor charges these management expenses to the residue. In determining the value of the residue passing to the spouse for marital deduction purposes, a reduction is made for Federal and State estate taxes payable from the residue but no reduction is made for the estate management expenses. If the management expenses are deducted on the estate's income tax return, the net value of the property passing to the spouse is $3,900,000 ($6,000,000 minus $2,100,000 Federal and State estate taxes). A marital deduction is claimed for that amount, and the taxable estate is $5,100,000.

Example 3. The facts are the same as in *Example 1*, except that the estate management expenses of $400,000 are incurred in connection with the bequest of ABC Corporation stock to the decedent's child. The executor charges these management expenses to the residue. For purposes of determining the marital deduction, the value of the residue is reduced by the Federal and State estate taxes and by the management expenses. The management expenses reduce the value of the residue because they are charged to the property passing to the spouse even though they were incurred with respect to stock passing to the child. If the management expenses are deducted on the estate's Federal income tax return, the marital deduction is $3,011,111 ($6,000,000 minus $400,000 management expenses and minus $2,588,889 Federal and State estate taxes). If the management expenses are deducted on the estate's Federal estate tax return, rather than on the estate's Federal income tax return, the marital deduction is $3,500,000 ($6,000,000 minus $400,000 management expenses and minus $2,100,000 in Federal and State estate taxes).

Example 4. The decedent, who dies in 2000, has a gross estate of $3,000,000.

Included in the gross estate are proceeds of $150,000 from a policy insuring the decedent's life and payable to the decedent's child as beneficiary. The applicable credit amount against the tax was fully consumed by the decedent's lifetime gifts. Applicable State law requires the child to pay any estate taxes attributable to the life insurance policy. Pursuant to the decedent's will, the rest of the decedent's estate passes outright to the surviving spouse. During the period of administration, the estate incurs estate management expenses of $150,000 in connection with the property passing to the spouse. The value of the property passing to the spouse is $2,850,000 ($3,000,000 less the insurance proceeds of $150,000 passing to the child). For purposes of determining the marital deduction, if the management expenses are deducted on the estate's income tax return, the marital deduction is $2,850,000 ($3,000,000 less $150,000) and there is a resulting taxable estate of $150,000 ($3,000,000 less a marital deduction of $2,850,000). Suppose, instead, the management expenses of $150,000 are deducted on the estate's estate tax return under section 2053 as expenses of administration. In such a situation, claiming a marital deduction of $2,850,000 would be taking a deduction for the same $150,000 in property under both sections 2053 and 2056 and would shield from estate taxes the $150,000 in insurance proceeds passing to the decedent's child. Therefore, in accordance with section 2056(b)(9), the marital deduction is limited to $2,700,000, and the resulting taxable estate is $150,000.

Example 5. The decedent dies after 2006 having made no lifetime gifts. The value of the decedent's residuary estate on the decedent's date of death is $3,000,000, before the payment of administration expenses and Federal and State estate taxes. The decedent's will provides a formula for dividing the decedent's residuary estate between two trusts to reduce the estate's Federal estate taxes to zero. Under the formula, one trust, for the benefit of the decedent's child, is to be funded with that amount of property equal in value to so much of the applicable exclusion amount under section 2010 that would reduce the estate's Federal estate tax to zero. The other trust, for the benefit of the surviving spouse, satisfies the requirements of section 2056(b)(7) and is to be funded with the remaining property in the estate. The State estate tax equals the State death tax credit available under section 2011. During the period of administration, the estate incurs transmission expenses of $200,000. The transmission expenses of $200,000 reduce the value of the residue to $2,800,000. If the transmission expenses are deducted on the Federal estate tax return, then the formula divides the residue so that the value of the property passing to the child's trust is $1,000,000 and the value of the property passing to the marital trust is $1,800,000. The allowable marital deduction is $1,800,000. The applicable exclusion amount shields from Federal estate tax the entire $1,000,000 passing to the child's trust so that the amount of Federal and State estate taxes is zero. Alternatively, if the transmission expenses are deducted on the estate's Federal income tax return, the formula divides the residue so that the value of the property passing to the child's trust is $800,000 and the value of the property passing to the marital trust is $2,000,000. The allowable marital deduction remains $1,800,000. The applicable exclusion amount shields from Federal estate tax the entire $800,000 passing to the child's trust and $200,000 of the $2,000,000 passing to the marital trust so that the amount of Federal and State estate taxes remains zero.

Example 6. The facts are the same as in *Example 5*, except that the decedent's will provides that the child's trust is to be funded with that amount of property equal in value to the applicable exclusion amount under section 2010 allowable to the decedent's estate. The residue of the estate, after the payment of any debts, expenses, and Federal and State estate taxes, is to pass to the marital trust. The applicable exclusion amount in this case is $1,000,000, so the value of the property passing to the child's trust is $1,000,000. After deducting the $200,000 of transmission expenses, the residue of the estate is $1,800,000 less any estate taxes. If the transmission expenses are deducted on the Federal estate tax return, the allowable marital deduction is $1,800,000, the taxable estate is zero, and the Federal and State estate taxes are zero. Alternatively, if the transmission expenses are deducted on the estate's Federal income tax return, the net value of the property passing to the spouse is $1,657,874 ($1,800,000 minus $142,106 estate taxes). A marital deduction is claimed for that amount, the taxable estate is $1,342,106, and the Federal and State estate taxes total $142,106.

Example 7. The decedent, who dies in 2000, makes an outright pecuniary bequest of $3,000,000 to the decedent's surviving spouse, and the residue of the estate, after the payment of all debts, expenses, and Federal and State estate taxes, passes to the decedent's child. Under the terms of the applicable local law, a beneficiary of a pecuniary bequest is not entitled to any income on the bequest. During the period of administration, the estate pays estate transmission expenses from the income earned by the property that will be distributed to the surviving spouse in satisfaction of the pecuniary bequest. The income earned on this property is not part of the marital share. Therefore, the allowable marital deduction is $3,000,000, unreduced by the amount of the estate transmission expenses.

(6) *Effective date.* The provisions of this paragraph (d) apply to estates of decedents dying on or after December 3, 1999.

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 22, 1999.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 2, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 3, 1999, 64 F.R. 67763)

Section 6501.—Limitations on Assessment and Collection

26 CFR 301.6501(c)–1: Exceptions to general period of limitations on assessment and collection.

T.D. 8845

DEPARTMENT OF THE TREASURY
Internal Revenue Service

26 CFR Part 20

Adequate Disclosure of Gifts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to changes made to Internal Revenue Code sections 2001, 2504, and 6501 by the Taxpayer Relief Act of 1997 and the Internal Revenue Service Restructuring and Reform Act of 1998 regarding the valuation of prior gifts in determining estate and gift tax liability, and the period of limitations for assessing and collecting gift tax. These regulations are necessary because section 6501(c)(9) now requires that a gift must be adequately disclosed on a gift tax return in order to commence the running of the period of limitations on assessment with respect to the gift. Once the period of limitations expires, the amount of that gift as reported on the return may not be adjusted for purposes of determining future gift and estate tax liability. The regulations provide guidance on what constitutes adequate disclosure for purposes of the statute.

DATES: These regulations are effective December 3, 1999.

FOR FURTHER INFORMATION CONTACT: William L. Blodgett, (202) 622-3090 (not a toll-free number).

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 (44 U.S.C. 3507) under control number 1545–1637. Responses to this collection of information are mandatory.

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

The reporting burden contained in §301.6501(c)–1(f) is reflected in the burden for Form 709, "U.S. Gift (and Generation-Skipping Transfer) Tax Return."

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

Books or records relating to this collection of information must be retained as long as their contents may be 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 December 22, 1998, the IRS published in the **Federal Register** (63 FR 70701) a notice of proposed rulemaking (REG–106177–98, 1998–2 C.B. 344) under sections 2001 and 2504 relating to the value of prior gifts for purposes of computing the estate and gift tax, and under section 6501 relating to the period for assessment and collection of gift tax. Written comments responding to the notice of proposed rulemaking were received and a hearing was held on April 28, 1999, at which time oral testimony was presented. This document adopts final regulations with respect to this notice of proposed rulemaking. A summary of the principal comments received and the revisions made in response to those comments is provided below.

1. *Requirements for Adequate Disclosure*

Under section 6501(c)(9), the period of limitations on the assessment of gift tax with respect to a gift will commence to run only if the gift is adequately disclosed on the gift tax return. The proposed regulations provide a list of information required to satisfy the adequate disclosure standard.

In general, the comments objected to the quantity, detail, and nature of the information required under the proposed regulations. In some cases, information required in the proposed regulations is not required in the final regulations. However, Treasury and the IRS continue to believe that the adequate disclosure rule was intended to afford the IRS a viable means to identify the returns that should be examined, with a minimum expenditure of resources. Further, the more complete and comprehensive the information filed with the return is, the more readily the IRS will be able to identify the returns that should not be examined, thus saving taxpayers needless expenditures of time and money.

Several commentators suggested that the language in §301.6501–1(f)(2) of the proposed regulations imposed two requirements for adequate disclosure. That is, the taxpayer had to provide information adequate to apprise the IRS of the nature of the gift, etc. and in addition, the taxpayer had to provide the information listed in the regulation. In response to these comments, the final regulations clarify that the adequate disclosure requirement is satisfied if the information listed in the regulation is provided.

Some commentators argued that Congress intended that the new adequate disclosure requirements be the same as the existing disclosure requirements under prior section 6501(c)(9) for pre-August 5, 1997 gifts of property subject to the special valuation rules of sections 2701 and 2702. Therefore, the commentators suggested that the IRS adopt the disclosure requirements under §301.6501(c)–1(e)(2) for transfers of those interests. This suggestion was not adopted. The IRS and Treasury believe it is necessary to expand on those disclosure requirements to address the broader range of transfers covered by the new legislation, as well as transactions and entities that may not have been prevalent when the prior regulations were promulgated.

Under the proposed regulations, if property is transferred in trust, taxpayers are required to provide a brief description of the terms of the trust. In response to comments, the final regulations provide that taxpayers may submit a complete copy of the trust document in lieu of a description of the trust terms.

The proposed regulations require the submission of a detailed description of the method used in determining the fair market value of the property, including "any relevant financial data." Commentators contended that "any relevant financial data" is a subjective concept that lacks specificity. Rather, the regulations should specify exactly what financial data must

be submitted, such as balance sheets, net earnings statements, etc. In response to these comments, the final regulations require that any financial data that was used in valuing the interest must be submitted. This ensures that the information requested is available and was deemed relevant by the person valuing the interest.

Several commentators expressed concern over the requirement in the proposed regulations that, if a less-than-100-percent interest in a non-actively traded entity is transferred, the taxpayer must submit a statement regarding the fair market value of 100 percent of the entity determined without regard to any discounts. It was contended that a less-than-100-percent interest in an operating company may not be valued based on a pro rata portion of the value of 100 percent of the entity; rather the appraiser often will determine the value based on indicia other than the value of the entire entity, such as the price/earnings ratio of stock in comparable publicly-traded entities. Because the entire entity is not valued in these situations, valuing 100 percent of the entity would not be relevant. One comment stated that this requirement would be reasonable in valuing an interest in nonactively-traded entities, such as entities holding securities or real estate, since in those cases the value of an interest in the entity would be determined based on a pro rata portion of the value of 100 percent of the entity. In response to these comments, the final regulations do not require a statement of the fair market value of 100 percent of the entity (without regard to any discounts), if the value of the interest in the entity is properly determined without using the net asset value of the entire entity. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity.

The proposed regulations also require valuation information for each entity (and its assets) that is owned or controlled by the entity subject to the transfer. Comments indicated that this requirement would be difficult to satisfy, because in some cases the information would not be within the control of the taxpayer and the entity subject to the transfer would not normally be required to maintain the financial records with respect to lower-tiered entities. The comments suggested that information on the lower-tiered entities should be required only to the extent such information is essential to a reasonable appraisal of the interest transferred and is in the personal control of the taxpayer. Many commentators suggested that the regulations require the submission of only that information that a qualified and competent appraiser would use in valuing the interest. In response to these comments, the final regulations provide that the information on the lower-tiered entities must be submitted if the information is relevant and material in determining the value of the interest in the entity.

Finally, comments suggested that a properly completed appraisal would contain all the information that is material and relevant to the valuation of the transferred property and, therefore, should be sufficient to satisfy any disclosure requirement. Accordingly, under the final regulations, an appraisal satisfying specific requirements may be submitted in lieu of a detailed description of the method used to determine the fair market value and in lieu of information regarding tiered entities.

The proposed regulations require a statement of relevant facts that would apprise the IRS of the nature of any potential gift tax controversy concerning the transfer, or instead of that statement, a concise description of the legal issue presented by the facts. This requirement is similar to the disclosure required to avoid the accuracy-related penalty under section 6662. It was intended to enable the IRS to easily identify issues presented so that the IRS could evaluate whether an examination is warranted during the initial review of the gift tax return. Commentators indicated that the requirement was too subjective and open-ended, since it would be difficult for a practitioner to identify or anticipate "any" potential controversy. In response to these comments, that requirement has been eliminated from the final regulations. The proposed regulations also require that the taxpayer submit a statement describing any position taken that is contrary to any temporary or final regulations or any revenue ruling. Commentators were concerned that this requirement could be interpreted as including both regulations and revenue rulings that are published after the gift tax return is filed that interpret earlier IRS positions. In response to these comments, the final regulations limit the required statement to positions taken that are contrary to any proposed, temporary or final regulation, and any revenue ruling published at the time the transfer occurred.

Commentators also noted that, under the proposed regulations, if a taxpayer failed to provide, for example, one item of information, the adequate disclosure requirement would not be satisfied, regardless of the significance of the item. The comments suggested that "substantial compliance" with the requirements of the regulations or a good-faith effort to comply should be deemed actual compliance. This suggestion was not adopted in view of the difficulty in defining and illustrating what would constitute substantial compliance. However, it is not intended that the absence of any particular item or items would necessarily preclude satisfaction of the regulatory requirements, depending on the nature of the item omitted and the overall adequacy of the information provided.

In response to comments, a rule was added regarding the application of the adequate disclosure rules in the case of "split gifts" under section 2513. Under this rule, gifts attributed to the non-donor spouse are deemed to be adequately disclosed if the gifts are adequately disclosed on the return filed by the donor spouse.

2. *Finality with Respect to Adequately Disclosed Gifts*

Under the proposed regulations, if a transfer is adequately disclosed on the gift tax return, and the period for assessment of gift tax has expired, then the IRS is foreclosed from adjusting the value of the gift under section 2504(c) (for purposes of determining the current gift tax liability) and under section 2001(f) (for purposes of determining the estate tax liability). However, the IRS is not precluded from making adjustments involving legal issues, even if the gift was adequately disclosed. This position was based on longstanding regulations applying section 2504(c) and relevant case law.

Comments suggested that this rule is contrary to Congressional intent in enacting section 2001(f) and amending section 2504(c) to provide a greater degree of fi-

nality with respect to the gift and estate tax statutory scheme. In response to these comments, the final regulations preclude adjustments with respect to all issues related to a gift once the gift tax statute of limitations expires with respect to that gift.

3. *Non-gift Transactions*

Under the proposed regulations, a completed transfer that did not constitute a gift would be considered adequately disclosed if the taxpayer submitted the information required for adequate disclosure and an explanation describing why the transfer was not subject to the gift tax. One commentator suggested that the adequate disclosure requirement should be waived if the taxpayer reasonably, in good faith, believes the transfer is not a gift (for example, a salary payment made to a child employed in a family business). Another commentator noted that the standard for adequate disclosure is higher for a "non-gift" than it is for a gift transaction since, in the non-gift situation, the donor must provide all the information required by the regulation and a statement why the transaction is not a gift. Another comment requested more guidance for reporting non-gift business transactions. In response to the comments, the final regulations limit the information required in a non-gift situation. In addition, the final regulations provide that completed transfers to members of the transferor's family (as defined in section 2032A(e)(2)) in the ordinary course of operating a business are deemed to be adequately disclosed, even if not reported on a gift tax return, if the item is properly reported by all parties for income tax purposes. For example, in the case of a salary payment made to a child of the donor employed in the donor's business, the transaction will be treated as adequately disclosed for gift tax purposes if the salary payment is properly reported by the business and the child on their income tax returns. This exception only applies to transactions conducted in the ordinary course of operating a business. It does not apply, for example, in the case of a sale of property (including a business) by a parent to a child.

4. *Effective Date Provisions*

Several comments were received regarding clarification of the statutory effective date rules.

One comment requested clarification of the effective date of section 6501(c)(9), as amended. The Taxpayer Relief Act of 1997 provides that the amendments to section 6501(c)(9) (commencing the running of the period of limitations only if the gift is adequately disclosed) apply to gifts made in calendar years ending after August 5, 1997 (that is, all gifts made in calendar year 1997 and thereafter). However, the underlying legislative history indicates that the amendment to section 6501(c)(9) applies "to gifts made in calendar years after the date of enactment [August 5, 1997]". H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 408 (1997). Notwithstanding this statement in the legislative history, the statutory language is clear that the section as amended applies to all gifts made during the 1997 calendar year, and thereafter. In the final regulations, the statutory effective date language is restated in a manner that makes it clear that section 6501(c)(9) as amended applies to all gifts made after December 31, 1996.

Another comment suggested clarification of the application of the adequate disclosure rules and the interaction between sections 2504(c) and 6501(c)(9) with respect to gifts made between January 1, 1997, and August 6, 1997, since section 2504(c) as amended applies only to gifts made after August 5, 1997, but section 6501(c)(9) as amended applies to all gifts made in 1997. In response to this comment, an example has been added under §25.2504–2(c) involving a situation where a gift is made prior to August 6, 1997, that is not adequately disclosed on the return filed for 1997. The example clarifies that the period for assessment with respect to the pre-August 6, 1997 gift does not commence to run because the gift is not adequately disclosed. Accordingly, a gift tax may be assessed with respect to the gift at any time, and notwithstanding the effective date for section 2504(c), that 1997 gift can be adjusted as a part of prior taxable gifts in determining subsequent gift tax liability. Further, the 1997 gift can be adjusted as part of taxable gifts under section 2001 in determining estate tax liability.

Finally, in response to another comment, an example has been added illustrating the application of the effective date rules in a similar fact pattern, where the gifts are made in a calendar year prior to 1997. The example illustrates that the IRS may not revalue the gifts, for purposes of determining prior taxable gifts for gift tax purposes, if a gift tax was paid and assessed with respect to the calendar year, and the period for assessment has expired. Since the gifts were made prior to 1997, the rules of section 2504(c) and section 6501 prior to amendment apply. However, the IRS may adjust the gifts for purposes of determining adjusted taxable gifts for estate tax purposes.

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. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is William L. Blodgett, Office of Assistant Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 20, 25, 301 and 602 are amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2001–1 is revised to read as follows:

§20.2001–1 Valuation of adjusted taxable gifts and section 2701(d) taxable events.

(a) *Adjusted taxable gifts made prior to August 6, 1997.* For purposes of determining the value of adjusted taxable gifts as defined in section 2001(b), if the gift was made prior to August 6, 1997, the value of the gift may be adjusted at any time, even if the time within which a gift tax may be assessed has expired under section 6501. This paragraph (a) also applies to adjustments involving issues other than valuation for gifts made prior to August 6, 1997.

(b) *Adjusted taxable gifts and section 2701(d) taxable events occurring after August 5, 1997.* For purposes of determining the amount of adjusted taxable gifts as defined in section 2001(b), if, under section 6501, the time has expired within which a gift tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) with respect to a gift made after August 5, 1997, or with respect to an increase in taxable gifts required under section 2701(d) and §25.2701–4 of this chapter, then the amount of the taxable gift will be the amount as finally determined for gift tax purposes under chapter 12 of the Internal Revenue Code and the amount of the taxable gift may not thereafter be adjusted. The rule of this paragraph (b) applies to adjustments involving all issues relating to the gift, including valuation issues and legal issues involving the interpretation of the gift tax law.

(c) *Finally determined.* For purposes of paragraph (b) of this section, the amount of a taxable gift as finally determined for gift tax purposes is—

(1) The amount of the taxable gift as shown on a gift tax return, or on a statement attached to the return, if the Internal Revenue Service does not contest such amount before the time has expired under section 6501 within which gift taxes may be assessed;

(2) The amount as specified by the Internal Revenue Service before the time has expired under section 6501 within which gift taxes may be assessed on the gift, if such specified amount is not timely contested by the taxpayer;

(3) The amount as finally determined by a court of competent jurisdiction; or

(4) The amount as determined pursuant to a settlement agreement entered into between the taxpayer and the Internal Revenue Service.

(d) *Definitions*. For purposes of paragraph (b) of this section, the amount is finally determined by a court of competent jurisdiction when the court enters a final decision, judgment, decree or other order with respect to the amount of the taxable gift that is not subject to appeal. See, for example, section 7481 regarding the finality of a decision by the U.S. Tax Court. Also, for purposes of paragraph (b) of this section, a settlement agreement means any agreement entered into by the Internal Revenue Service and the taxpayer that is binding on both. The term includes a closing agreement under section 7121, a compromise under section 7122, and an agreement entered into in settlement of litigation involving the amount of the taxable gift.

(e) *Expiration of period of assessment.* For purposes of determining if the time has expired within which a tax may be assessed under chapter 12 of the Internal Revenue Code, see §301.6501(c)–1(e) and (f) of this chapter.

(f) *Effective dates*. Paragraph (a) of this section applies to transfers of property by gift made prior to August 6, 1997, if the estate tax return for the donor/decedent's estate is filed after December 3, 1999. Paragraphs (b) through (e) of this section apply to transfers of property by gift made after August 5, 1997, if the gift tax return for the calendar period in which the gift is made is filed after December 3, 1999.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 3. The authority citation for part 25 continues to read in part as follows:

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

Par. 4. In §25.2504–1, a sentence is added at the end of paragraph (d) to read as follows:

§25.2504–1 Taxable gifts for preceding calendar periods.

* * * * *

(d) * * * However, see §25.2504–2(b) regarding certain gifts made after August 5, 1997.

Par. 5. Section 25.2504–2 is revised to read as follows:

§25.2504–2 Determination of gifts for preceding calendar periods.

(a) *Gifts made before August 6, 1997.* If the time has expired within which a tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in §25.2502–1(c)(2), the gift was made prior to August 6, 1997, and a tax has been assessed or paid for such prior calendar period, the value of the gift, for purposes of arriving at the correct amount of the taxable gifts for the preceding calendar periods (as defined under §25.2504–1(a)), is the value used in computing the tax for the last preceding calendar period for which a tax was assessed or paid under chapter 12 of the Internal Revenue Code or the corresponding provisions of prior laws. However, this rule does not apply where no tax was paid or assessed for the prior calendar period. Furthermore, this rule does not apply to adjustments involving issues other than valuation. See §25.2504–1(d).

(b) *Gifts made or section 2701(d) taxable events occurring after August 5, 1997.* If the time has expired under section 6501 within which a gift tax may be assessed under chapter 12 of the Internal Revenue Code (or under corresponding provisions of prior laws) on the transfer of property by gift made during a preceding calendar period, as defined in §25.2502–1(c)(2), or with respect to an increase in taxable gifts required under section 2701(d) and §25.2701–4, and the gift was made, or the section 2701(d) taxable event occurred, after August 5, 1997, the amount of the taxable gift or the amount of the increase in taxable gifts, for purposes of determining the correct amount of taxable gifts for the preceding calendar periods (as defined in §25.2504–1(a)), is the amount that is finally determined for gift tax purposes (within the meaning of §20.2001–1(c) of this chapter) and such amount may not be thereafter adjusted. The rule of this paragraph (b) applies to adjustments involving all issues relating to the gift including valuation issues and legal issues involving the interpretation of the gift tax law. For purposes of determining if the time has

expired within which a gift tax may be assessed, see §301.6501(c)–1(e) and (f) of this chapter.

(c) *Examples*. The following examples illustrate the rules of paragraphs (a) and (b) of this section:

Example 1. (i) *Facts*. In 1996, A transferred closely-held stock in trust for the benefit of B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B. No gift tax was assessed or paid as a result of the gift tax annual exclusion and the application of A's available unified credit. In 2001, A transferred additional closely-held stock to the trust. A's Federal gift tax return reporting the 2001 transfer was timely filed and the transfer was adequately disclosed under §301.6501(c)–1(f)(2) of this chapter. In computing the amount of taxable gifts, A claimed annual exclusions with respect to the transfers in 1996 and 2001. In 2003, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts*. Under section 2504(c), in determining A's 2003 gift tax liability, the amount of A's 1996 gift can be adjusted for purposes of computing prior taxable gifts, since that gift was made prior to August 6, 1997, and therefore, the provisions of paragraph (a) of this section apply. Adjustments can be made with respect to the valuation of the gift and legal issues presented (for example, the availability of the annual exclusion with respect to the gift). However, A's 2001 transfer was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the 2001 taxable gift by A may not be adjusted (either with respect to the valuation of the gift or any legal issue) for purposes of computing prior taxable gifts in determining A's 2003 gift tax liability.

Example 2. (i) *Facts*. In 1996, A transferred closely-held stock to B, A's child. A timely filed a Federal gift tax return reporting the 1996 transfer to B and paid gift tax on the value of the gift reported on the return. On August 1, 1997, A transferred additional closely-held stock to B in exchange for a promissory note signed by B. Also, on September 10, 1997, A transferred closely-held stock to C, A's other child. On April 15, 1998, A timely filed a gift tax return for 1997 reporting the September 10, 1997, transfer to C and, under §301.6501(c)–1(f)(2) of this chapter, adequately disclosed that transfer and paid gift tax with respect to the transfer. However, A believed that the transfer to B on August 1, 1997, was for full and adequate consideration and A did not report the transfer to B on the 1997 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts*. Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1996 gift cannot be adjusted for purposes of computing the value of prior taxable gifts, since that gift was made prior to August 6, 1997, and a timely filed Federal gift tax return was filed on which a gift tax was assessed and paid. However, A's prior taxable gifts can be adjusted to reflect the August 1, 1997, transfer because, although a gift tax return for 1997 was timely filed and gift tax was paid, under §301.6501(c)–1(f) of this chapter the period for assessing gift tax with respect to the August 1, 1997, transfer did not commence to run since that transfer was not adequately disclosed on the 1997 gift tax return. Accordingly, a gift tax may be assessed with respect to the August 1, 1997, transfer and the amount of the gift would be reflected in prior taxable gifts for purposes of computing A's gift tax liability for 2002. A's September 10, 1997, transfer to C was adequately disclosed on a timely filed gift tax return and, thus, under paragraph (b) of this section, the amount of the September 10, 1997, taxable gift by A may not be adjusted for purposes of computing prior taxable gifts in determining A's 2002 gift tax liability.

Example 3. (i) *Facts*. In 1994, A transferred closely-held stock to B and C, A's children. A timely filed a Federal gift tax return reporting the 1994 transfers to B and C and paid gift tax on the value of the gifts reported on the return. Also in 1994, A transferred closely-held stock to B in exchange for a bona fide promissory note signed by B. A believed that the transfer to B in exchange for the promissory note was for full and adequate consideration and A did not report that transfer to B on the 1994 Federal gift tax return. In 2002, A transfers additional property to B and timely files a Federal gift tax return reporting the gift.

(ii) *Application of the rule limiting adjustments to prior gifts*. Under section 2504(c), in determining A's 2002 gift tax liability, the value of A's 1994 gifts cannot be adjusted for purposes of computing prior taxable gifts because those gifts were made prior to August 6, 1997, and a timely filed Federal gift tax return was filed with respect to which a gift tax was assessed and paid, and the period of limitations on assessment has expired. The provisions of paragraph (a) of this section apply to the 1994 transfers. However, for purposes of determining A's adjusted taxable gifts in computing A's estate tax liability, the gifts may be adjusted. See §20.2001–1(a) of this chapter.

(d) *Effective dates*. Paragraph (a) of this section applies to transfers of property by gift made prior to August 6, 1997. Paragraphs (b) and (c) of this section apply to transfers of property by gift made after August 5, 1997, if the gift tax return for the calendar period in which the transfer is reported is filed after December 3, 1999**.**

Par. 6. In §25.2511–2, paragraph (j) is revised to read as follows:

§25.2511–2 Cessation of donor's dominion and control.

* * * * *

(j) If the donor contends that a power is of such nature as to render the gift incomplete, and hence not subject to the tax as of the calendar period (as defined in §25.2502–1(c)(1)) of the initial transfer, see §301.6501(c)–1(f)(5) of this chapter.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 7. The authority citation for part 301 continues to read in part as follows:

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

Par. 8. Section 301.6501(c)–1 is amended by:

1. Revising the heading to paragraph (e).

2. Adding paragraph (f).

The revision and addition reads as follows:

§301.6501(c)–1 Exceptions to general period of limitations on assessment and collection.

* * * * *

(e) *Gifts subject to chapter 14 of the In-*

*ternal Revenue Code not adequately disclosed on the return. * * **

(f) *Gifts made after December 31, 1996, not adequately disclosed on the return*— (1) *In general*. If a transfer of property, other than a transfer described in paragraph (e) of this section, is not adequately disclosed on a gift tax return (Form 709, "United States Gift (and Generation-Skipping Transfer) Tax Return"), or in a statement attached to the return, filed for the calendar period in which the transfer occurs, then any gift tax imposed by chapter 12 of subtitle B of the Internal Revenue Code on the transfer may be assessed, or a proceeding in court for the collection of the appropriate tax may be begun without assessment, at any time.

2) *Adequate disclosure of transfers of property reported as gifts.* A transfer will be adequately disclosed on the return only if it is reported in a manner adequate to apprise the Internal Revenue Service of the nature of the gift and the basis for the value so reported. Transfers reported on the gift tax return as transfers of property by gift will be considered adequately disclosed under this paragraph (f)(2) if the return (or a statement attached to the return) provides the following information—

(i) A description of the transferred property and any consideration received by the transferor;

(ii) The identity of, and relationship between, the transferor and each transferee;

(iii) If the property is transferred in trust, the trust's tax identification number and a brief description of the terms of the trust, or in lieu of a brief description of the trust terms, a copy of the trust instrument;

(iv) Except as provided in §301.6501–1(f)(3), a detailed description of the method used to determine the fair market value of property transferred, including any financial data (for example, balance sheets, etc. with explanations of any adjustments) that were utilized in determining the value of the interest, any restrictions on the transferred property that were considered in determining the fair market value of the property, and a description of any discounts, such as discounts for blockage, minority or fractional interests, and lack of marketability, claimed in valuing the property. In the case of a transfer of an interest that is actively traded on an established exchange, such as the New York Stock Exchange, the American Stock Exchange, the NASDAQ National Market, or a regional exchange in which quotations are published on a daily basis, including recognized foreign exchanges, recitation of the exchange where the interest is listed, the CUSIP number of the security, and the mean between the highest and lowest quoted selling prices on the applicable valuation date will satisfy all of the requirements of this paragraph (f)(2)(iv). In the case of the transfer of an interest in an entity (for example, a corporation or partnership) that is not actively traded, a description must be provided of any discount claimed in valuing the interests in the entity or any assets owned by such entity. In addition, if the value of the entity or of the interests in the entity is properly determined based on the net value of the assets held by the entity, a statement must be provided regarding the fair market value of 100 percent of the entity (determined without regard to any discounts in valuing the entity or any assets owned by the entity), the pro rata portion of the entity subject to the transfer, and the fair market value of the transferred interest as reported on the return. If 100 percent of the value of the entity is not disclosed, the taxpayer bears the burden of demonstrating that the fair market value of the entity is properly determined by a method other than a method based on the net value of the assets held by the entity. If the entity that is the subject of the transfer owns an interest in another non-actively traded entity (either directly or through ownership of an entity), the information required in this paragraph (f)(2)(iv) must be provided for each entity if the information is relevant and material in determining the value of the interest; and

(v) A statement describing any position taken that is contrary to any proposed, temporary or final Treasury regulations or revenue rulings published at the time of the transfer (see §601.601(d)(2) of this chapter).

(3) *Submission of appraisals in lieu of the information required under paragraph (f)(2)(iv) of this section.* The requirements of paragraph (f)(2)(iv) of this section will be satisfied if the donor submits an appraisal of the transferred property that meets the following requirements—

(i) The appraisal is prepared by an appraiser who satisfies all of the following requirements:

(A) The appraiser is an individual who holds himself or herself out to the public as an appraiser or performs appraisals on a regular basis.

(B) Because of the appraiser's qualifications, as described in the appraisal that details the appraiser's background, experience, education, and membership, if any, in professional appraisal associations, the appraiser is qualified to make appraisals of the type of property being valued.

(C) The appraiser is not the donor or the donee of the property or a member of the family of the donor or donee, as defined in section 2032A(e)(2), or any person employed by the donor, the donee, or a member of the family of either; and

(ii) The appraisal contains all of the following:

(A) The date of the transfer, the date on which the transferred property was appraised, and the purpose of the appraisal.

(B) A description of the property.

(C) A description of the appraisal process employed.

(D) A description of the assumptions, hypothetical conditions, and any limiting conditions and restrictions on the transferred property that affect the analyses, opinions, and conclusions.

(E) The information considered in determining the appraised value, including in the case of an ownership interest in a business, all financial data that was used in determining the value of the interest that is sufficiently detailed so that another person can replicate the process and arrive at the appraised value.

(F) The appraisal procedures followed, and the reasoning that supports the analyses, opinions, and conclusions.

(G) The valuation method utilized, the rationale for the valuation method, and the procedure used in determining the fair market value of the asset transferred.

(H) The specific basis for the valuation, such as specific comparable sales or transactions, sales of similar interests, asset-based approaches, merger-acquisition transactions, etc.

(4) *Adequate disclosure of non-gift completed transfers or transactions.*

Completed transfers to members of the transferor's family, as defined in section 2032A(e)(2), that are made in the ordinary course of operating a business are deemed to be adequately disclosed under paragraph (f)(2) of this section, even if the transfer is not reported on a gift tax return, provided the transfer is properly reported by all parties for income tax purposes. For example, in the case of salary paid to a family member employed in a family owned business, the transfer will be treated as adequately disclosed for gift tax purposes if the item is properly reported by the business and the family member on their income tax returns. For purposes of this paragraph (f)(4), any other completed transfer that is reported, in its entirety, as not constituting a transfer by gift will be considered adequately disclosed under paragraph (f)(2) of this section only if the following information is provided on, or attached to, the return—

(i) The information required for adequate disclosure under paragraphs (f)(2)(i), (ii), (iii) and (v) of this section; and

(ii) An explanation as to why the transfer is not a transfer by gift under chapter 12 of the Internal Revenue Code.

(5) *Adequate disclosure of incomplete transfers.* Adequate disclosure of a transfer that is reported as a completed gift on the gift tax return will commence the running of the period of limitations for assessment of gift tax on the transfer, even if the transfer is ultimately determined to be an incomplete gift for purposes of §25.2511–2 of this chapter. For example, if an incomplete gift is reported as a completed gift on the gift tax return and is adequately disclosed, the period for assessment of the gift tax will begin to run when the return is filed, as determined under section 6501(b). Further, once the period of assessment for gift tax expires, the transfer will not be subject to inclusion in the donor's gross estate for estate tax purposes. On the other hand, if the transfer is reported as an incomplete gift whether or not adequately disclosed, the period for assessing a gift tax with respect to the transfer will not commence to run even if the transfer is ultimately determined to be a completed gift. In that situation, the gift tax with respect to the transfer may be assessed at any time, up until three years after the donor files a return reporting the transfer as a completed gift with adequate disclosure.

(6) *Treatment of split gifts.* If a husband and wife elect under section 2513 to treat a gift made to a third party as made one-half by each spouse, the requirements of this paragraph (f) will be satisfied with respect to the gift deemed made by the consenting spouse if the return filed by the donor spouse (the spouse that transferred the property) satisfies the requirements of this paragraph (f) with respect to that gift.

(7) *Examples.* The following examples illustrate the rules of this paragraph (f):

Example 1. (i) *Facts.* In 2001, A transfers 100 shares of common stock of XYZ Corporation to A's child. The common stock of XYZ Corporation is actively traded on a major stock exchange. For gift tax purposes, the fair market value of one share of XYZ common stock on the date of the transfer, determined in accordance with §25.2512–2(b) of this chapter (based on the mean between the highest and lowest quoted selling prices), is $150.00. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A reports the gift to A's child of 100 shares of common stock of XYZ Corporation with a value for gift tax purposes of $15,000. A specifies the date of the transfer, recites that the stock is publicly traded, identifies the stock exchange on which the stock is traded, lists the stock's CUSIP number, and lists the mean between the highest and lowest quoted selling prices for the date of transfer.

(ii) *Application of the adequate disclosure standard.* A has adequately disclosed the transfer. Therefore, the period of assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b)).

Example 2. (i) *Facts.* On December 30, 2001, A transfers closely-held stock to B, A's child. A determined that the value of the transferred stock, on December 30, 2001, was $9,000. A made no other transfers to B, or any other donee, during 2001. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A provides the information required under paragraph (f)(2) of this section such that the transfer is adequately disclosed. A claims an annual exclusion under section 2503(b) for the transfer.

(ii) *Application of the adequate disclosure standard.* Because the transfer is adequately disclosed under paragraph (f)(2) of this section, the period of assessment for the transfer will expire as prescribed by section 6501(b), notwithstanding that if A's valuation of the closely-held stock was correct, A was not required to file a gift tax return reporting the transfer under section 6019. After the period of assessment has expired on the transfer, the Internal Revenue Service is precluded from redetermining the amount of the gift for purposes of assessing gift tax or for purposes of determining the estate tax liability. Therefore, the amount of the gift as reported on A's 2001 Federal gift tax return may not be redetermined for purposes of determining A's prior taxable gifts (for gift tax purposes) or A's adjusted taxable gifts (for estate tax purposes).

Example 3. (i) *Facts.* A owns 100 percent of the common stock of X, a closely- held corporation. X does not hold an interest in any other entity that is not actively traded. In 2001, A transfers 20 percent of the X stock to B and C, A's children, in a transfer that is not subject to the special valuation rules of section 2701. The transfer is made outright with no restrictions on ownership rights, including voting rights and the right to transfer the stock. Based on generally applicable valuation principles, the value of X would be determined based on the net value of the assets owned by X. The reported value of the transferred stock incorporates the use of minority discounts and lack of marketability discounts. No other discounts were used in arriving at the fair market value of the transferred stock or any assets owned by X. On A's Federal gift tax return, Form 709, for the 2001 calendar year, A provides the information required under paragraph (f)(2) of this section including a statement reporting the fair market value of 100 percent of X (before taking into account any discounts), the pro rata portion of X subject to the transfer, and the reported value of the transfer. A also attaches a statement regarding the determination of value that includes a discussion of the discounts claimed and how the discounts were determined.

(ii) *Application of the adequate disclosure standard.* A has provided sufficient information such that the transfer will be considered adequately disclosed and the period of assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b)).

Example 4. (i) *Facts.* A owns a 70 percent limited partnership interest in PS. PS owns 40 percent of the stock in X, a closely-held corporation. The assets of X include a 50 percent general partnership interest in PB. PB owns an interest in commercial real property. None of the entities (PS, X, or PB) is actively traded and, based on generally applicable valuation principles, the value of each entity would be determined based on the net value of the assets owned by each entity. In 2001, A transfers a 25 percent limited partnership interest in PS to B, A's child. On the Federal gift tax return, Form 709, for the 2001 calendar year, A reports the transfer of the 25 percent limited partnership interest in PS and that the fair market value of 100 percent of PS is $y and that the value of 25 percent of PS is $z, reflecting marketability and minority discounts with respect to the 25 percent interest. However, A does not disclose that PS owns 40 percent of X, and that X owns 50 percent of PB and that, in arriving at the $y fair market value of 100 percent of PS, discounts were claimed in valuing PS's interest in X, X's interest in PB, and PB's interest in the commercial real property.

(ii) *Application of the adequate disclosure standard.* The information on the lower tiered entities is relevant and material in determining the value of the transferred interest in PS. Accordingly, because A has failed to comply with requirements of paragraph (f)(2)(iv) of this section regarding PS's interest in X, X's interest in PB, and PB's interest in the commercial real property, the transfer will not be considered adequately disclosed and the period of assessment for the transfer under section 6501 will remain open indefinitely.

Example 5. The facts are the same as in *Example 4* except that A submits, with the Federal tax return, an appraisal of the 25 percent limited partnership in-

terest in PS that satisfies the requirements of paragraph (f)(3) of this section in lieu of the information required in paragraph (f)(2)(iv) of this section. Assuming the other requirements of paragraph (f)(2) of this section are satisfied, the transfer is considered adequately disclosed and the period for assessment for the transfer under section 6501 will run from the time the return is filed (as determined under section 6501(b) of this chapter).

Example 6. A owns 100 percent of the stock of X Corporation, a company actively engaged in a manufacturing business. B, A's child, is an employee of X and receives an annual salary paid in the ordinary course of operating X Corporation. B reports the annual salary as income on B's income tax returns. In 2001, A transfers property to family members and files a Federal gift tax return reporting the transfers. However, A does not disclose the 2001 salary payments made to B. Because the salary payments were reported as income on B's income tax return, the salary payments are deemed to be adequately disclosed. The transfer of property to family members, other than the salary payments to B, reported on the gift tax return must satisfy the adequate disclosure requirements under paragraph (f)(2) of this section in order for the period of assessment under section 6501 to commence to run with respect to those transfers.

(8) *Effective date.* This paragraph (f) is applicable to gifts made after December 31, 1996, for which the gift tax return for such calendar year is filed after December 3, 1999.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 9. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 10. In §602.101, paragraph (b) is amended in the table by revising the entry for 301.6501(c)–1 to read as follows:

§602.101 OMB Control numbers.

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
301.6501(c)–1	1545–1241 1545–1637
* * * * *	

* * * * *

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved November 18, 1999

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 2, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 3, 1999, 64 F.R. 67767)

Part III. Administrative, Procedural, and Miscellaneous

Section 705 Special Basis Rules

Notice 99–57

The Internal Revenue Service intends to promulgate regulations under § 705 of the Internal Revenue Code to address certain situations where gain or loss may be improperly created by adjusting the basis of a partnership interest for partnership income that is not subject to tax, or for partnership losses or deductions that are permanently denied, with respect to a partner.

BACKGROUND

Section 705(a) provides that the adjusted basis of a partner's interest in a partnership generally shall be increased by the partner's distributive share of (i) taxable income of the partnership as determined under § 703(a), (ii) income of the partnership exempt from tax, and (iii) the excess of the deduction for depletion over the basis of the property subject to depletion. Conversely, the adjusted basis of a partner's interest in a partnership generally shall be decreased by the partner's distributive share of (i) losses of the partnership, (ii) nondeductible expenditures not properly chargeable to capital account, and (iii) in certain cases, deductions for depletion.

The legislative history describing § 705(a) states that adjusting the basis of a partner's interest is necessary to prevent unintended benefit or detriment to the partners. Thus, a partner should add to the basis of the partner's partnership interest the partner's distributive share of nontaxable income so that the partner does not lose the benefit of that type of tax-exempt income. Otherwise, the partner could eventually incur a capital gain with respect to such amounts. H.R. Rep. No. 1337, 83d Cong., 2d Sess. A225 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 384 (1954).

Rev. Rul. 96–11, 1996–1 C.B. 140, provides an example of how § 705 has been interpreted to carry out the purposes of this legislative history. There, a partnership made a charitable contribution of property with a basis of $60x and fair market value of $100x in a transaction that qualified under § 170(c). The ruling states that "[i]n determining whether a transaction results in exempt income within the meaning of § 705(a)(1)(B), or a nondeductible, noncapital expenditure within the meaning of § 705(a)(2)(B), the proper inquiry is whether the transaction has a permanent effect on the partnership's basis in its assets, without a corresponding current or future effect on its taxable income." The ruling explains that the partners' bases in their partnership interests should be reduced only by their respective shares of the permanent decrease in the partnership's asset basis. This preserves the deduction for the fair market value of appreciated property without the recognition of the appreciation. Reducing the partners' bases in their partnership interests by the fair market value of the property contributed to the charity would subsequently cause the partners to recognize gain (or a reduced loss) upon a disposition of their interests in the partnership attributable to the unrecognized appreciation in the property at the time of the contribution. See also Rev. Rul. 96–10, 1996–1 C.B. 138, which discusses adjustments to basis in partnership interests where loss on sale of partnership property is denied under § 707(b)(1) and subsequent gain is not recognized under §§ 267(d) and 707(b)(1).

Section 743(a) provides that the basis of partnership property shall not be adjusted as the result of the transfer of a partnership interest by sale or exchange or on the death of a partner unless an election under § 754 is in effect with respect to the partnership.

Section 743(b) provides that, in the case of a transfer of an interest in a partnership by sale or exchange or upon the death of a partner, a partnership with respect to which an election under § 754 is in effect shall (i) increase the basis of the partnership property by the excess of the basis to the transferee partner of the transferee partner's interest in the partnership over the transferee partner's proportionate share of the adjusted basis of the partnership property, or (ii) decrease the adjusted basis of the partnership property by the excess of the transferee partner's proportionate share of the adjusted basis of the partnership property over the basis of the transferee partner's interest in the partnership.

The partnership rules generally attempt to preserve equality between a partner's basis in the partnership interest and the partner's share of inside basis in the assets of the partnership. In order to promote administrative convenience, however, § 743(a) departs from this general rule, allowing a partner's basis in its partnership interest to diverge from the partner's share of basis in partnership assets in situations where the partnership has not made an election under § 754.

The failure to make a § 754 election generally will result in a timing benefit or detriment to the partner or partners with divergent inside and outside bases. For instance, consider the situation where a person (*A*) purchases a 50 percent interest in a partnership for $100x. The partnership owns one asset with a basis of $100x and a value of $200x. If the partnership had made a § 754 election, *A* would have a $50x special basis adjustment in the property, so that when the partnership disposed of the property for $200x, *A*'s special basis adjustment would exactly offset *A*'s allocated share of the gain. *A*'s basis in the partnership interest would remain at $100x after the sale. Accordingly, *A* would not recognize any gain upon the sale of the partnership interest immediately thereafter.

If the partnership had not made a § 754 election, *A* would have no special basis adjustment, so that when the partnership disposed of the property for $200x, *A* would be allocated $50x of gain. *A*'s basis in the partnership interest would increase to $150x under § 705(a)(1)(A), so that *A* would recognize an offsetting $50x loss (or reduced gain) upon a subsequent sale of the partnership interest. Thus, without the § 754 election, there may be a timing detriment to *A*, but the correct amount of cumulative income or loss (albeit possibly of a different character) is ultimately reported by *A*.

The correct amount of cumulative income may not be reported, however, in certain situations in which *A* is not subject to tax on the gain that results from the failure to make the § 754 election. For instance, in the example discussed immediately above, if *A* was a corporation and the property held by the partnership was *A* stock, under § 1032, the gain allocated to

A (assuming that no § 754 election had been made) would not be subject to tax. See Rev. Rul. 99–57, published in this issue of the Internal Revenue Bulletin. In this situation, it would be inconsistent with the intent of § 705 to increase the basis of *A*'s partnership interest for the non-recognized gain. To do so would create a recognizable loss in a situation where no offsetting gain had previously been recognized.

DESCRIPTION OF REGULATIONS

The regulations will apply specifically to situations where a corporation acquires an interest in a partnership that holds stock in that corporation, and a § 754 election is not in effect with respect to the partnership for the taxable year of the acquisition. In those situations, a corporate partner may increase its basis in its partnership interest under § 705 only by the amount of its share of § 1032 gain that the partner would have realized had a § 754 election been made. Rules regarding tiered-entity structures also will apply.

It is intended that the regulations also will apply to other situations where the price paid for a partnership interest reflects built-in gain or accrued income items that will not be subject to income tax, or built-in loss or accrued deductions that will be permanently denied, when allocated to the transferee partner, and the partnership has not made an election under § 754. Comments are requested as to the appropriate scope of the regulations in this regard.

EFFECTIVE DATES

In situations where a corporate partner is allocated gain that is subject to § 1032, and the basis of the stock was not adjusted upon the purchase of the partnership interest by the corporate partner under § 743(b), the regulations shall apply to gain or loss allocated with respect to sales of partner stock occurring after December 6, 1999. In other situations, the regulations will apply to gain or loss realized or income or deductions taken into account after the date of publication of proposed regulations. Moreover, the Service may challenge any transaction within the scope of this Notice under the anti-abuse provisions of § 1.701–2 of the Income Tax Regulations, as appropriate.

The principal author of this notice is Robert Honigman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice contact Robert Honigman at (202) 622-3050 (not a toll-free call).

Opportunity to Obtain a Debt Indicator in a Pilot Program for Tax Year 1999 Form 1040 IRS *e-file* and On-Line Returns

Notice 99–58

SUMMARY: Authorized IRS *e-file* Providers, Form 1040 On-Line Transmitters and financial institutions may apply to obtain a Debt Indicator for their customer/client taxpayers in exchange for actively screening individual income tax returns and return information for potential fraud and abuse and to reporting the findings to the IRS in accordance with a proposal accepted by the IRS.

ADDRESSES: Questions or concerns should be directed to Lisa Johnson at the IRS, Electronic Tax Administration, Electronic Program Operations Office, OP:ETA:O:C, New Carrollton Federal Building, ATTN: Lisa Johnson, 5000 Ellin Road C4–187, Lanham, MD 20706 or via E-mail at LJJOHN00@m1.irs.gov or faxed to (202) 283-4786, ATTN: Lisa Johnson.

SUPPLEMENTARY INFORMATION

Background

The Debt Indicator is useful to taxpayers who wish to use their anticipated individual income tax return refunds to apply for bank products, for example, refund anticipation loans. The Debt Indicator tells a taxpayer whether or not there are any scheduled offsets against the refund by IRS, for example, for back taxes, or by the Financial Management Service (FMS), for example, for outstanding child support or federal debts, such as student loans. These bank products are offered by financial institutions in conjunction with tax practitioners that file returns electronically. An indicator called the Direct Deposit Indicator or DDI was available to taxpayers seeking bank products prior to 1994. The DDI was discontinued because it was thought to be a contributing factor to fraudulent claims for the Earned Income Tax Credit. The new Debt Indicator seeks to address this issue through a joint fraud detection program. Authorized IRS *e-file* Providers, Form 1040 On-Line Filers, and financial institutions will sign agreements with the IRS to actively screen returns and return information for potential fraud and abuse and report findings to the IRS. Parties to the agreements are eligible to obtain the Debt Indicator for their taxpayers who apply for bank products and sign consents to disclose the Debt Indicator to Authorized IRS *e-file* Providers, Form 1040 On-Line Filers, and financial institutions. The application and instructions for applying to obtain an agreement follow.

APPROVED

Terence H. Lutes,
National Director,
Electronic Program Operations Office,
Electronic Tax Administration.

(Filed by the Office of the Federal Register on December 1, 1999, 8:45 a.m., and published in the issue of the Federal Register for December 2, 1999, 64 F.R. 67621)

Application for Memorandum of Agreement
Debt Indicator

Name:
DBA Name:
Address:
Authorized Representative: **Phone Number:** **Fax Number:**
ETIN(s):
EFIN(s) Covered **By This Proposal:** **(attach separate sheet if necessary)**

IRS Authorized Representative: Lisa Johnson **Phone Number: (202) 283-0980** **Fax Number: (202) 283-4786** **E-mail: LJJOHN00@m1.irs.gov**
Address: IRS **Attn: Lisa Johnson, OP:ETA:O:C** **5000 Ellin Road** **Lanham, MD 20706**

1. INTRODUCTION

(A) The Internal Revenue Service (IRS) faces the challenge of eliminating barriers by providing incentives and using competitive market forces to make progress towards its goal to electronically transact 80% of IRS business by the year 2007 and the interim goal that, to the extent practicable, all returns prepared electronically should be filed electronically by the year 2002. One of these incentives was the issuance of the Debt Indicator Pilot Request For Agreement (RFA) that was issued on June 22, 1999. This RFA provided the opportunity for electronic return originators (EROs), transmitters and On-line service providers to obtain a Debt Indicator in exchange for screening the returns they transmit for potential abuse. Authorized *e-file* providers and financial institutions that did not submit proposals under this RFA or are not covered under one of the announced agreements may still apply to obtain the DI for the upcoming filing season through this Memorandum of Agreement (MOA).(B) The Electronic Tax Administration (ETA) MOA between the Internal Revenue Service (IRS) and the Participant sets forth the complete agreement of the parties with regard to participation in the Debt Indicator Pilot for electronically filed individual (1040 series) federal income tax returns during the 2000 filing season which covers the 1999 tax year. The parties agree that, except as provided below, the participant will be treated as an ERO, On-line service provider, transmitter, software developer or financial institution for the 2000 IRS *e-file* program as those terms are defined in Revenue Procedures 98-50 and 98-51. Also, except as provided below, the parties agree to comply with all relevant statutory, regulatory, and administrative requirements relating to the electronic filing program.

(C) The IRS is looking for creative and innovative abuse and fraud detection beyond what is required in Revenue Procedures 98-50 and 98-51 in addition to creative and innovative ways to perform the due diligence required by these Revenue Procedures. Partnered proposals offer

greater opportunities for more comprehensive screening of returns and return information and have a greater chance of being accepted by the IRS.

2. AUTHORITY

This Agreement is entered into pursuant to (1) the authority vested in the Commissioner of the IRS by Treasury Order 150-10 to administer and enforce the internal revenue laws and revenue procedures for electronic filing and (2) the authority vested in the Secretary of the Treasury by the IRS Restructuring and Reform Act of 1998, implemented in Section 6011 of the Internal Revenue Code, to promote the benefits of and encourage the use of ETA programs.

3. BACKGROUND AND PURPOSE

In exchange for providing the screening procedures in the accepted proposal, the IRS will provide to the taxpayer through the selected Participant, a debt indicator for taxpayers who have entered into an agreement with a financial institution. This indicator may show the reason that the refund changed was because of a debt owed to either the IRS or Financial Management Service (FMS) or both.

The return software must also be modified to include a voluntary consent to disclose when the RAL indicator field is significant. This authorizes the Service to provide the debt indicator when financial agreements have been made with the taxpayer.

4. DEFINITIONS

(A) "Days" as used herein means calendar days unless otherwise stated.

(B) A "fraudulent return" is a return in which the individual is attempting to file using someone else's name or SSN on the return or where the taxpayer is presenting documents or information that have no basis in fact. NOTE: Fraudulent returns should not be filed with the Service.

(C) A "potentially abusive return" is a return (1) that is not a fraudulent return; (2) that the taxpayer is required to file; (3) but that may contain inaccurate or unsubstantiated information (including, but not limited to, the information subject to reporting) that may lead to an understatement of a liability or an overstatement of a credit, and production of a refund to which the taxpayer may not be entitled. NOTE: The decision not to provide a RAL or other bank product does not necessarily make it an abusive return.

(D) Refund offset is the reduction of the taxpayer's claimed refund in whole or in part for unpaid IRS tax debt or past-due debts submitted to FMS' Treasury Offset Program for child support arrearages, Federal agency non-tax debt, or state income tax.

(E) Refund delay is the suspension of the refund process resulting from systemic reviews.

(F) Sub-Participant is an ERO, On-line service provider, Transmitter, or Financial Institution other than the Participant who has entered into an Agreement with the Participant to perform some of the duties and responsibilities of the Participant.

5. DUTIES AND RESPONSIBILITIES OF THE PARTICIPANT

(A) The Participant will perform all the screening activities included in the checklist submitted with, and incorporated by reference into, this Agreement.

(B) The Participant must agree to track and report (by SSN) to the IRS on a weekly basis, the potentially abusive federal individual income tax returns electronically filed and the reason(s) the return may be abusive. The format is as follows and should be delivered via electronic mail to HQ-ORF@ci.irs.gov.

Field Name	Field Length	Format
Filer EFIN	6	Alpha/Numeric
Primary SSN	9	Alpha/Numeric
W2	1	Alpha (Y or blank)
Dependents	1	Alpha (Y or blank)
Schedule C	1	Alpha (Y or blank)
Filing Status Change	1	Alpha (Y or blank)
Telephone # Invalid	1	Alpha (Y or blank)
Duplicate SSN	1	Alpha (Y or blank)
Invalid SSN	1	Alpha (Y or blank)
Duplicate Address	1	Alpha (Y or blank)
Other	1	Alpha (Y or blank)
Return Filed	1	Alpha (Y or blank)
Explanation of Other	250	Alpha

Filer EFIN — Electronic Filer Identification Number of the ERO processing the return.

Primary SSN — Primary SSN on the return, which is suspected of abuse/fraud.

W2 — the W2 was the reason for suspecting abuse/fraud.

Dependents — questions about the dependents was the reason for suspecting fraud (i.e. last name of dependent is different from taxpayer).

Schedule C — no substantiation for the Schedule C.

Filing Status Change — questions about the filing status changes was the reason for suspecting abuse/fraud.

Telephone # Invalid — telephone numbers given by the taxpayer were found to be either invalid, disconnected, or that the taxpayer was not known by the person answering the telephone.

Duplicate SSN — a duplicate primary, secondary, dependent or EIC qualifying SSN is found within the ERO's own universe of returns.

Invalid SSN — the ERO determines that the primary, secondary, dependent or EIC qualifying SSN is invalid.

Duplicate Address — multiple returns filed for the same address for seemingly

unrelated taxpayers found within the ERO's own universe of returns.

Other — any reason, not conforming to those previously listed, for which a return could be considered fraudulent.

Return Filed — the "Y" will indicate that the return was filed and blank will mean that the return was not filed.

If you have additional information, provide it in a flat file format, comma delimited (e.g., SSN information on returns that were not processed).

(C) The Participant will provide the Service with a Final Pilot Finding report. This report will be sent to the Authorized IRS Representative via email no later than May 31, 2000. The report shall include information on each of the following items:

- Number of RALs applied for and 1999 vs. 2000 comparison
- Average amount of RAL and 1999 vs. 2000 comparison
- Distribution of RAL applicants with respect to adjusted gross income (AGI)
- Range of fees charged for RALs
- Comparison of fees prior to DI pilot
- Breakdown of e-filers between RAL applicants and non-RAL applicants and 1999 vs. 2000 comparison

6. LIABILITY

The IRS shall not be liable for any injury to the Participant's personnel or damage to the Participant's property unless such injury or damage is due to negligence on the part of the Government and is recoverable under the Federal Tort Claims Act [28 U.S.C. 1346(b)], or pursuant to other statutory authority.

7. THIRD PARTY RIGHTS

This Agreement does not alter, change, or eliminate any rights or responsibilities that taxpayers have under the Internal Revenue Code.

8. PERIOD OF PERFORMANCE AND TERMINATION

(A) This Agreement shall be in effect from the date of IRS' signature for the 2000 filing season with an option to extend for the 2001 filing season subject to a modification of the agreement.

(B) This Agreement may be terminated by either party upon 30 days after receipt of written notice signed by either of the signatories to this Agreement or by their successors or designees. The Participant understands that in the event the IRS terminates this Agreement, the Participant has no right to any claim against the Government, including a claim for termination costs.

9. MODIFICATION

This Agreement may be modified by the IRS, and the Participant may submit requests for modifications to the IRS Authorized Representative. All modifications must be in writing and signed by both of the signatories to this Agreement or by their successors or designees.

10. INSPECTION

(A) The IRS has the right to inspect the work performed by the Participant or any Sub-Participant as stated below. If the duties and responsibilities of the Participant or any Sub-Participant are not being met, then the IRS may terminate this Agreement for default, and the Participant and any Sub-Participant may be suspended from the IRS *e-file* program.

(B) The IRS may inspect the work performed by the Participant upon reasonable notice to the Participant's Authorized Representative and in a manner that will not interfere with the Participant's performance of this Agreement. The Participant shall provide access for this purpose to the IRS' Authorized Representative(s) to the location where the work is being performed. The IRS shall also have the right to inspect the Participant's Report(s) of the work performed as a result of this Agreement. The IRS's Authorized Representative shall provide the results of any inspections to the Participant's Authorized Representative for any necessary resolution.

11. RELEASE OF INFORMATION

The Participant shall provide written notice to the IRS and obtain consent in advance of releasing any national press releases for the purposes of performing the work described in this Agreement or publicizing this partnership with the IRS. The text and purpose of the intended release shall be provided to the IRS's Authorized Representative for this Agreement. The Service may monitor advertising standards as authorized in Section 12 of Revenue Procedure 98-50.

12. REMEDIES

There are no remedies other than the termination rights described in 11(B) and (C) of this Agreement unless provided in a modification to this Agreement. The Contract Disputes Act does not apply.

13. ORDER OF PRECEDENCE

In the event the terms of this Agreement are inconsistent with the terms of the checklist, the Agreement shall take precedence.

14. GOVERNING LAW

This Agreement is subject to and governed by the laws of the United States of America, that is, by Federal law, and not by the laws of any State. The terms of this Agreement are not intended to alter, modify, or rescind any current Agreement or provision of Federal law now in effect. Any provision of this Agreement that conflicts with Federal law will be null and void.

SIGNATURES

_____

Participant

_____

Terence H. Lutes
National Director, ETA

INSTRUCTIONS

The IRS is encouraging the formation of partnerships among EROs, transmitters, software developers and financial institutions to meet the requirements of this agreement more efficiently and to cover more participants. These partnerships may apply as a group and the privileges obtained through successful applications will be extended to all member partners.

Software developers, transmitters and financial institutions are encouraged to initiate these partnership applications on behalf of their customers — EROs, direct transmitters, small banks — to ensure that their entire customer bases have access to the Debt Indicator. Partnered proposals offer greater opportunities for more com-

prehensive screening of returns and return information and have a greater chance of being accepted by the IRS.

Individual EROs that apply will need to negotiate changes with their software company before they can participate.

In order to receive this indicator for you and/or your clients, use the application and sample checklist (Attachment 1) as resources to formulate your submission. Include all screening procedures currently employed by all members of the partnership. This could include cross-checks of all data received from EROs that could identify improbable information; software checks that can identify abusive scenarios within ERO practices and fraudulent or abusive situations; transmitter databases that can identify duplicated information as well as facilitating the reporting process; and fraud screening services and other checks.

Attachment 1

SAMPLE CHECKLIST

	Current Check	Willing to Do for 2000
ERO		
-Identification		
Require two forms of valid identification (one must be a photo ID)	☐	☐
Verify telephone numbers	☐	☐
Verify residence	☐	☐
-Social Security Card		
Require a valid SSN card for all SSNs on return	☐	☐
-Maintain Previous Client Database		
Document change in filing status	☐	☐
Document change in number or names of dependents	☐	☐
Document multiple returns to same address in prior year	☐	☐
INCOME VERIFICATION		
- Questionable W–2s		
Verification of W–2s when one of the following exist: • Typed, handwritten or altered forms • W–2's with all copies attached • Unknown companies (out of area) • W–2s that differ from other forms issued from the same company	☐	☐
- Schedule C or Other Income Reporting Forms		
Documentation of income	☐	☐
Validation and recording of expenses	☐	☐
- EITC and Filing Status Verification		
Complete Due Diligence worksheet	☐	☐
Document lack of child care expenses where potential exists	☐	☐
Utilize tax package and requirements to ensure:		
• A child can be claimed as a dependent	☐	☐
• The taxpayer can qualify as Head of Household	☐	☐
• A child can be considered as a qualifying child for EITC purposes	☐	☐

	Current Check	Willing to Do for 2000
- Return Verification		
Document Schedule A deductions	☐	☐
Software Developer		
Validate SSNs are within valid ranges	☐	☐
Check for Duplicate SSNs	☐	☐
Check for Multiple Head of Household Returns at the same address	☐	☐
Check for improbable Federal withholding amounts	☐	☐
Check for incorrect Social Security or Medicare Withholding	☐	☐
Verify math computations are correct	☐	☐
Verify format is correct	☐	☐
Transmitter		
Verify ERO suitability	☐	☐
Maintain databases for the following:		
Duplicate SSNs	☐	☐
Addresses and phone numbers for jails, drug treatment centers, health/welfare agencies, hotels, etc.	☐	☐
SSNs of deceased persons	☐	☐
Credit card fraud	☐	☐
Bank		
Contract with a fraud screening service for bank products connected to tax returns	☐	☐
Request Credit Reports for loan customers	☐	☐

Other

Feel free to add any additional screens you currently employ. Attach additional pages as necessary.

Use this space to further describe any of the above screens. Attach additional pages as necessary.

Part IV. Items of General Interest

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organizations listed below have recently filed timely declaratory judgment suits under section 7428 of the Code, challenging revocation of their status as eligible donees under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

Sta-Home Home Health Agency, Inc.
Jackson, MS

Sta-Home Home Health Agency, Inc.
of Forest, Mississippi
Jackson, MS

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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