Internal Revenue
bulletin

Bulletin No. 2000–44
October 30, 2000

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8905, page 435.

Final regulations relate to preparer due diligence requirements under section 6695(g) of the Code for determining earned income credit (EIC) eligibility.

REG–246249–96, page 439.

Proposed regulations under sections 6041 and 6045 of the Code provide guidance on information returns for persons that make payments on behalf of another person or jointly to two or more payees, or in connection with certain sales involving investment advisers. A public hearing is scheduled for February 7, 2001.

REG–105235–99, page 447.

Proposed regulations under section 121 of the Code relate to the exclusion of gain from the sale or exchange of a taxpayer's principal residence. A public hearing is scheduled for January 23, 2001.

REG–108553–00, page 452.

Proposed regulations under section 7701 of the Code relate to the classification of certain pension and employee benefit trusts and certain investment trusts as domestic trusts for federal tax purposes. A public hearing is scheduled for January 31, 2001.

EMPLOYEE PLANS

Announcement 2000–71, page 456.

Qualified plans; amendments; section 411(d)(6). This announcement assists practitioners and plan sponsors in requesting determination letters with respect to certain amendments to qualified plans made as a result of regulations that were published under section 411(d)(6) of the Code on September 6, 2000.

Announcement 2000–86, page 456.

The Service announces a change to the distribution codes to be used on Form 1099-R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*, when making distributions from IRAs.

EXEMPT ORGANIZATIONS

Rev. Rul. 2000–49, page 430.

Reporting requirements for section 527 organizations. This ruling provides questions and answers regarding the notice and reporting requirements of section 527 of the Code.

Announcement 2000–87, page 457.

A list is given of organizations now classified as private foundations.

ADMINISTRATIVE

Rev. Proc. 2000–46, page 438.

This procedure provides that the Service will not rule on the question of whether an undivided fractional interest in real property is an interest in a partnership. Rev. Proc. 2000–3 amplified.

Announcement 2000–88, page 460.

This document contains corrections to a removal of final regulations (T.D. 8897, 2000–36 I.R.B. 234) relating to the application of section 263A of the Code to property production in the trade or business of farming.

Finding Lists begin on page ii.
Actions Relating to Court Decisions is on the page following the introduction.

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.

Actions Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. "Nonacquiescence" signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a "nonacquiescence" indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The Actions on Decisions published in the weekly Internal Revenue Bulletin are consolidated semiannually and appear in the first Bulletin for July and the Cumulative Bulletin for the first half of the year. A semiannual consolidation also appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

John D. Shea v. Commissioner,[1]
112 T.C. 183 (1999)

[1] Nonacquiescence relating to whether the burden of proof will be placed on the Commissioner for any issue where the statutory notice of deficiency fails to meet the standards set forth in I.R.C. section 7522.

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

Section 527.—Political Organizations

26 CFR 1.527–2: Definitions.
(Also §§ 6012, 6033, 6104, and 6652.)

Reporting requirements for section 527 organizations. This ruling provides questions and answers regarding the notice and reporting requirements for section 527.

Rev. Rul. 2000–49

ISSUES

On July 1, 2000, Pub. L. 106–230 was enacted, amending § 527 of the Code. The new law imposes three reporting and disclosure requirements on political organizations described in § 527: (1) an initial notice of status, (2) periodic reports of contributions and expenditures, and (3) annual returns. This revenue ruling provides questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527.

QUESTIONS AND ANSWERS

I. *Notice of Status*

1. Q. What is the notice of status requirement for an organization described in § 527?

A. Under § 527(i)(1)(A), a political organization is required to give notice both electronically and in writing to the Service that it is a political organization described in § 527.

2.Q. What is the required notice form?

A. The required notice form is Form 8871, *Political Organization Notice of Section 527 Status*.

3. Q. Are all political organizations required to file the Form 8871 notice?

A. No. Under § 527(i)(5) and § 527(i)(6), three types of organizations are not required to file the Form 8871 notice:

(a) Persons required to report under the Federal Election Campaign Act of 1971 (FECA) as a political committee (see 2 U.S.C. § 431(4));

(b) Organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000; and

(c) Organizations described in § 501(c) that are subject to § 527(f)(1) because they have made an "exempt function" expenditure.

All other political organizations, including state and local candidate committees, are required to file the notice.

4. Q. Is a political organization required to file Form 8871 if it does not know whether it will have annual gross receipts of $25,000 or more for any taxable year?

A. A newly established political organization is not required to file Form 8871 if it reasonably anticipates that its annual gross receipts will be less than $25,000 for its first six taxable years. However, if an organization, in fact, does have annual gross receipts of $25,000 or more for any taxable year, it is required to file Form 8871 within 30 days of receiving $25,000.

5.Q. Is the separate segregated fund established under § 527(f)(3) by a § 501(c) organization required to file Form 8871?

A. A § 501(c) organization that is not prohibited from participating in political campaign activity has the option of conducting the activity itself or setting up a separate segregated fund. If the § 501(c) organization conducts the activity itself, it is subject to tax under § 527(f)(1) on the lesser of its investment income or the amount of its political expenditures, but it is not required to file Form 8871 pursuant to § 527(i)(5)(A). If the § 501(c) organization establishes a separate segregated fund, the fund is treated as a separate political organization under § 527(f)(3) and does not qualify for the exception under § 527(i)(5)(A). Therefore, unless it meets one of the other exceptions, the separate segregated fund is required to file Form 8871.

6. Q. Is an organization that finances both federal and non-federal election activity required to file the Form 8871 notice?

A. As a general rule, any political organization (whether or not separately incorporated) that is organized and operated primarily for an exempt function under § 527(e)(2) (see Q&A-17) must file Form 8871 unless it meets one of the exceptions discussed above (see Q&A-3), one of which is being required to report under FECA as a political committee. An organization that finances election activity (within the meaning of FECA) for both federal and non-federal elections may establish a political committee to receive contributions and make expenditures for both federal and non-federal election activity. In that case, the organization must register as a political committee and comply with the FECA contribution limitations and reporting requirements. 11 C.F.R. 102.5(a)(1)(ii). Such an organization is, therefore, not required to file Form 8871.

If, however, the organization sets up separate accounts to conduct its federal election activity and its non-federal election activity, the federal account is treated as a separate political committee that is required to register and report under FECA. 11 C.F.R. 102.5(a)(1)(i). The treatment of the federal account as a separate committee is consistent with the organizational requirements for political organizations under § 527, as discussed below in Q&A-12. Accordingly, the separate federal account is not required to file Form 8871. However, a separate non-federal account is not required to register and report under FECA as a political committee. Therefore, a separate non-federal account that is described in § 527(e)(1) is required to file Form 8871.

7. Q. Are political organizations that are required to report to state or local election agencies excepted from the notice requirement?

A. Section 527(i) does not except political organizations that file reports with state or local election agencies from the notice of status requirement. Therefore, unless the political organization meets one of the exceptions discussed above in Q&A-3, it must file Form 8871 with the Service.

8. Q. When must the organization file Form 8871?

A. Form 8871 must be filed within 24 hours after the date on which the organization was established. See Notice 2000–36, 2000–33 I.R.B. 173 for information about filing requirements for organizations in existence before July 30, 2000.

9. Q. What are the methods of filing Form 8871?

A. Section 527(i)(1)(A) requires that the organization file Form 8871 both electronically and in writing. Therefore, the methods for filing Form 8871 are as follows:

(a) Electronically via the Internal Revenue Service Internet Web Site (IRS Web Site) at www.irs.gov./polorgs, and

(b) In writing by sending a signed copy of Form 8871 to the Internal Revenue Service Center, Ogden, UT 84201. An organization can fill in and print out the form from the IRS Web Site.

10. Q. Must an organization take any additional steps before filing Form 8871?

A. Before filing Form 8871, the political organization must have its own employer identification number (EIN) even if it has no employees. To obtain an EIN, an organization must file Form SS-4, *Application for Employer Identification Number*, with the Service (see Q&A-52).

11. Q. What information must be provided in the Form 8871 notice?

A. Under § 527(i)(3), an organization must provide in its Form 8871 notice its name and address (including any business address, if different) and electronic mailing address; its purpose; the names and addresses of its officers, highly compensated employees, contact person, custodian of records, and members of its Board of Directors; and the name and address of, and relationship to, any related entities (within the meaning of § 168(h)(4)).

12. Q. Does § 527(i) change the organizational requirements for § 527 organizations?

A. No. Section 527 does not require an organization to have formal organizational documents, such as articles of incorporation. Under § 1.527–2(a)(2) of the Income Tax Regulations, a political organization meets the organizational test if it is organized for the primary purpose of carrying on exempt function activities as defined in § 527. The regulation specifically states that the organization need not be formally chartered or established as a corporation, trust, or association. For example, a separate bank account can qualify as a political organization. See Rev. Rul. 79–11, 1979–1 C.B. 207.

The requirement that a § 527 organization include the names and addresses of its officers, highly compensated employees, and members of its Board of Directors does not change the organizational test for § 527. Section 527(i) does not require political organizations to be organized with Boards of Directors, officers and highly compensated employees. It merely requires the organization to provide their names and addresses if it is so organized.

13. Q. What is a "related entity" for this purpose?

A. An entity is a "related entity" within the meaning of § 168(h)(4), which provides that an organization is related to another entity as follows:

(a) The two entities have (i) significant common purposes and substantial common membership or (ii) directly or indirectly substantial common direction or control; or

(b) Either entity owns (directly or through one or more entities) a 50 percent or greater interest in the capital or profits of the other. For this purpose, entities treated as related entities under (a) above shall be treated as one entity.

14. Q. What are "highly compensated employees" for this purpose?

A.Highly compensated employees for this purpose are the five employees (other than officers and directors) who are reasonably expected to have the highest annual compensation over $50,000. Compensation includes both cash and noncash amounts, whether paid currently or deferred, for the 12-month period that began with the date the organization was formed (if the organization was formed after June 30, 2000). If the organization was already in existence on June 30, 2000, it must use the accounting period that includes July 1, 2000.

15. Q. What if an organization described in § 527(e)(1) does not file the Form 8871 notice?

A. An organization described in § 527(e)(1) must file Form 8871 unless it is an organization described in § 527(i)(5) or § 527(i)(6) (see Q&A-3). If the organization fails to file Form 8871 on a timely basis, § 527(i)(4) provides that until the organization satisfies the notice requirement, the taxable income of the organization includes its exempt function income (including contributions received, membership dues, and political fundraising receipts), minus any deductions directly connected with the production of that income. For purposes of computing its taxable income, the organization may not deduct its exempt function expenditures because § 162(e) denies a deduction for political campaign expenditures.

Under § 527(b), the tax is computed by multiplying the organization's taxable income (including its net investment income) by the highest corporate tax rate, currently 35 percent. The organization must file a Form 1120-POL to report the income and pay the tax.

16. Q. When is an organization described in § 527(e)(1)?

A. An organization is described in § 527(e)(1) if it meets both the organizational and operational tests, that is, it must be organized and operated primarily for the purpose of accepting contributions or making expenditures for an exempt function under § 527(e)(2). See § 1.527–2(a).

17. Q. What is an "exempt function" under § 527(e)(2)?

A. "Exempt function" means, under § 527(e)(2), influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

18. Q. Are transfers to political organizations that fail to file Form 8871 subject to the gift tax?

A. Section 2501(a)(5) provides that the gift tax does not apply to transfers of money or other property to political organizations within the meaning of § 527(e)(1). Therefore, transfers to an organization described in § 527(e)(1) (see Q&A-16) are not subject to the gift tax, regardless of whether the organization has filed Form 8871.

19. Q. Is the Form 8871 notice publicly available?

A. Yes. Under § 6104(a), Form 8871 (including any supporting papers), and any letter or other document the Service issues with regard to Form 8871, will be open to public inspection. Copies of Form 8871 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)–3 of the Procedure and Administration Regulations, as long as the organization provides the IRS Web Site address to the per-

son making the request. In addition, the organization is required to make a copy of these materials available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. § 6104(d).

20. Q. What is the penalty on the organization for failure to comply with the public inspection requirement?

A. Under § 6652(c)(1)(D), a penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues.

II. Periodic Reporting Requirements

21. Q. What are the periodic reporting requirements imposed upon political organizations?

A. Under § 527(j), a political organization is required to periodically report certain contributions it receives and expenditures it makes.

22. Q. What is the required periodic reporting form?

A. The required periodic reporting form is Form 8872, *Political Organization Report of Contributions and Expenditures*.

23. Q. When are political organizations required to file periodic reports on Form 8872?

A. Under § 527(j)(2), political organizations that accept contributions or make expenditures for an exempt function under § 527 (see Q&A-17) during a calendar year are required to file periodic reports on Form 8872, beginning with the first month or quarter in which they accept contributions or make expenditures. In addition, organizations that make contributions or expenditures with respect to an election for federal office (as defined in § 527(j)(6)) may be required to file pre-election reports for that election.

24. Q. Are all political organizations required to file periodic reports on Form 8872?

A. No, § 527(j)(5) provides that some organizations are not subject to this requirement. The organizations excepted from the filing requirements are as follows:

a) Organizations excepted from the requirement to file a Form 8871 (see Q&A-3);

b) Political committees of a state or local candidate, including political committees of state or local officeholders; and

c) State and local committees of political parties.

All other political organizations, including state and local political action committees, are subject to the reporting requirements of § 527(j), even if they file reports with state or local election agencies.

25. Q. Must a state or local candidate or officeholder organize a formal committee to be excepted from the Form 8872 filing requirements?

A. No. As discussed in Q&A-12, § 527 does not require organizations to have formal organizational documents. Therefore, a candidate or officeholder does not need to organize a formal committee to qualify for the exception under § 527(j)(5) for committees of state or local candidates.

26. Q. Are political organizations that engage in exempt function activities (as defined in § 527(e)(2)) solely with respect to elections for state or local offices excepted from the Form 8872 filing requirements?

A. No. Although the timing of the reports is based upon federal elections (see Q&A-34), the requirement to file the reports is based on accepting contributions or making expenditures for an exempt function under § 527(e)(2) (see Q&A-17). Therefore, unless a political organization meets one of the exceptions discussed above in Q&A-24, it must file Form 8872 with the Service.

27. Q. Is an organization that reasonably anticipated it would not have annual gross receipts of $25,000 or more required to file Form 8872 if it, in fact, receives $25,000 or more in any taxable year?

A. An organization that receives $25,000 in any taxable year no longer qualifies for the exception in § 527(j)(5)(C) and, therefore, must begin filing Form 8872 unless it meets one of the other exceptions discussed in Q&A-24. The organization must file, within 30 days of receiving $25,000, any Form 8872 that would otherwise have been due during the calendar year prior to that date.

28. Q. How often must the Form 8872 be filed?

A. A political organization subject to the periodic reporting requirement may choose to file Form 8872 on a monthly basis or on a quarterly/semi-annual basis, but it must file on the same basis for the entire calendar year.

29. Q. What is an election year and non-election year for purposes of determining the due dates for filing Form 8872?

A. An election year is any year in which a regularly scheduled general election for federal office is held, i.e., any even-numbered year. A non-election year is therefore any odd-numbered year.

30. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(B), a political organization that chooses to file monthly must file Form 8872 reports not later than the 20th day after the end of the month, which must be complete as of the last day of the month. December activity is included in the year-end report which is due not later than January 31 of the following year.

31. Q. If an organization chooses to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(B), in any election year (i.e., even-numbered years), monthly reports are due not later than the 20th day after the end of the month (see Q&A-30), except the organization shall not file the reports regularly due in November and December (i.e., the monthly reports for activity in October and November). Instead, the organization must file a Form 8872 report not later than 12 days before the general election (or 15 days before the general election if posted by registered or certified mail) that contains information through the 20th day before the general election. The organization must also file a report no more than 30 days after the general election which shall contain information through the 20th day after the election. The December activity is included in the year-end report due not later than January 31 of the following year.

32. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due in a non-election year?

A. Pursuant to § 527(j)(2)(A), a political organization that chooses not to file monthly must file semi-annual reports in non-election years (i.e., odd-numbered years). These reports are due not later

than July 31 for the first half of the year and, for the second half of the year, not later than January 31 of the following year.

33. Q. If an organization chooses not to file on a monthly basis, when is Form 8872 due during an election year?

A. Pursuant to § 527(j)(2)(A), in an election year (even-numbered years), an organization that chooses not to file monthly reports must file quarterly reports not later than the 15th day after the last day of the quarter, except that the return for the final quarter shall be due not later than January 31 of the following year. The organization must also file a post-general election report not later than 30 days after the general election that contains information through the 20th day after the election. In addition, the organization must file a pre-election report for any election for federal office with respect to which the organization makes a contribution or expenditure. These reports shall be filed not later than 12 days before the election (15 days before if posted by registered or certified mail) and must contain information through the 20th day before the election.

34. Q. What is an election for purposes of the reporting deadlines under § 527(j)?

A. For purposes of determining what is an election year and what elections trigger the pre-election and post-general election reports, § 527(j)(6) provides that an "election" is a general, special, primary, or runoff election for a federal office; a convention or caucus of a political party with authority to nominate a candidate for federal office; a primary election to select delegates to a national nominating convention of a political party; or a primary election to express a preference for the nomination of individuals for election to the office of President. Thus, an election for purpose of these reporting deadlines does not include a purely state or local election. When an election involves both candidates for federal office and candidates for state or local offices, it is an election for purposes of the reporting deadlines, but only those organizations that make contributions or expenditures with respect to the candidates for federal office are required to file the pre-election reports for those elections under § 527(j)(2)(A)(i)(II). However, all reports filed under § 527(j) must contain information about the contributions and expenditures within the reporting period, regardless of whether they were accepted or made with respect to candidates for federal, state or local office.

35. Q. What is a general election?

A. A general election is either one of the following:

a) an election for federal office held in even numbered years on the Tuesday following the first Monday in November or

b) an election held to fill a vacancy in a federal office (i.e., a special election) that is intended to result in the final selection of a single individual to the office at stake. See 11 C.F.R. 100.2(b).

36. Q. How will "election" under § 527(j)(6) be interpreted?

A. The definition of "election" under § 527(j)(6) is virtually identical to the definition of "election" under FECA (2 U.S.C. § 431(1)). Organizations may rely on FEC interpretations of the FECA definition in the absence of further guidance from the Service. The FEC publishes information concerning the filing requirements under FECA and the dates for filing those reports, including information on the dates of elections, on its Web Site at http://www.fec.gov/pages/report.htm.

37. Q. What must a Form 8872 report contain?

A. The report must include the name, address, and (if an individual) the occupation and employer, of any person to whom expenditures are made that aggregate $500 or more in a calendar year and the amount of such expenditure. The report must also include the name, address, and (if an individual) the occupation and employer, of any person that contributes in the aggregate $200 or more in a calendar year and the amount of such contribution. However, an organization is not required to report independent expenditures, as defined in § 301 of FECA. Only expenditures made or contributions received after July 1, 2000, that are not made or received pursuant to binding contracts entered into before July 2, 2000, must be reported.

38. Q. What is an independent expenditure under § 301 of FECA?

A. An independent expenditure is an expenditure by a person expressly advocating the election or defeat of a clearly identified candidate for federal office which is made without cooperation or consultation with any candidate for federal office, or any authorized committee or agent of such candidate, and which is not made in concert with, or at the request or suggestion of, any candidate for federal office, or authorized committee or agent of such candidate. See 2 U.S.C. § 431(17).

39. Q. Where is the Form 8872 filed?

A. The report is filed by sending a signed copy of Form 8872 to the Internal Revenue Service Center, Ogden, UT 84201. The form must be signed by an official authorized by the organization to sign the report.

40. Q. What if a political organization that has filed Form 8871 does not file the required Form 8872?

A. Under § 527(j)(1), a political organization that does not file the required Form 8872 or which fails to include the information required on the Form 8872 is subject to a penalty equal to the amount of contributions and expenditures that are not disclosed multiplied by the highest corporate tax rate, currently 35 percent.

41. Q. Is the Form 8872 filed by political organizations publicly available?

A. Yes. Under § 6104(b) and § 6104(d)(6), Form 8872 will be made available for public inspection by the Service. Copies of Form 8872 that have been filed are currently available at the IRS Web Site at www.irs.gov/polorgs and are considered widely available under § 301.6104(d)–3, as long as the organization provides the IRS Web Site address to the person making the request. In addition, under § 6104(d)(1)(A), the organization is required to make a copy of these reports available for public inspection during regular business hours at the organization's principal office (and at each of its regional or district offices having at least three paid employees) in the same manner as applications for exemption of § 501(c) organizations are made available. Pursuant to § 6104(b) and § 6104(d)(3)(A), contributor information must be disclosed to the public.

42. Q. What if the political organization does not make its Form 8872 publicly available?

A. Under § 6652(c)(1)(C), a penalty of $20 per day may be imposed on any

person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one report is $10,000.

III. *Annual Return Requirements*

43. Q. Which political organizations are required to file annual income tax returns?

A. A political organization that has taxable income in excess of the $100 specific deduction allowed under § 527 is required to file an annual income tax return on Form 1120-POL, *U.S. Income Tax Return for Certain Political Organizations*. In addition, for taxable years beginning after June 30, 2000, a political organization that has $25,000 or more in gross receipts for the taxable year is also required to file Form 1120-POL, without regard to whether it has taxable income. § 6012(a)(6).

44. Q. When is the Form 1120-POL due?

A. The Form 1120-POL is due on or before the 15th day of the third month after the close of the organization's taxable year. § 6072(b). Thus, for a calendar-year taxpayer, Form 1120-POL is due on March 15 of the following year.

45. Q. Which political organizations are required to file an annual information return?

A. A political organization that is required under § 6012(a)(6) to file an income tax return is also required to file Form 990, *Return of Organization Exempt from Income Tax*, for taxable years beginning after June 30, 2000. § 6033(g). Organizations with gross receipts less than $100,000 and assets less than $250,000 may file Form 990-EZ, *Short Form Return of Organization Exempt from Income Tax*. Organizations with gross receipts of less than $25,000 are not required to file Form 990 or Form 990-EZ.

46. Q. When is the Form 990 due?

A. The Form 990 (or Form 990-EZ) is due on or before the 15th day of the fifth month after the close of the organization's taxable year. Thus, for a calendar-year taxpayer, Form 990 is due on May 15 of the following year.

47. Q. What if the political organization fails to file Form 1120-POL or Form 990?

A. A political organization that fails to file a required Form 1120-POL or Form 900 or fails to include required information on those returns is subject to a penalty of $20 per day for every day such failure continues. The maximum penalty imposed regarding any one return is the lesser of $10,000 or 5 percent of the gross receipts of the organization for the year. In the case of an organization having gross receipts exceeding $1,000,000 for any year, the penalty is increased to $100 per day with a maximum penalty of $50,000. § 6652(c)(1)(A).

48. Q. Are the Forms 1120-POL and Forms 990 filed by political organizations publicly available?

A. Yes, the Forms 1120-POL and the Forms 990 filed for taxable years beginning after June 30, 2000 will be made available for public inspection by the Service. § 6104(b). In addition, each political organization must make a copy of its returns available for public inspection during regular business hours at its principal office (and any regional or district offices having at least three paid employees) in the same manner as annual information returns of § 501(c) organizations are made available. It must also provide a copy of the returns to any person requesting a copy in person or in writing without charge other than a reasonable charge for reproduction and postage in the same manner that § 501(c) organizations provide copies of their annual returns. § 6104(d)(1). If an organization's returns are widely available under § 301.6104(d)–3 (such as on the Internet), the organization need not respond to requests for copies so long as it provides the web site address where the returns are available to the person making the request. Returns only need to be made available for three years after filing. § 6104(d)(2). Contributor information must be disclosed to the public. § 6104(d)(3)(A).

49. Q. What if the political organization does not make its Forms 1120-POL and Forms 990 publicly available?

A. A penalty of $20 per day may be imposed on any person with a duty to comply with the public inspection requirement for each day a failure to comply continues. The maximum penalty that may be incurred for any failure to disclose any one return is $10,000. § 6652(c) (1)(C).

IV. *General*

50. Q. What if the filing date for any of these forms falls on Saturday, Sunday or a holiday?

A. If any due date falls on a Saturday, Sunday or legal holiday, the organization may file the report on the next business day.

51. Q. Where can organizations get copies of the various forms?

A. The various forms (Form SS-4, Form 8871, Form 8872, Form 1120-POL, and Form 990) and their instructions are available by calling 1-800-TAX-FORM (1-800-829-3676) or via the Internet at the IRS Web Site at www.irs.gov in the "Forms and Publications" section.

52. Q. What if an organization has questions regarding the notice and reporting requirements or has any problem obtaining an EIN?

A. For more information or if an organization has any problem obtaining an EIN, organizations may call the TE/GE Customer Service Center at 1-877-829-5500.

DRAFTING INFORMATION

The principal author of this announcement is Judith E. Kindell of Exempt Organizations. For further information regarding this announcement contact Judith E. Kindell at (202) 622-6494 (not a toll-free call).

Section 6012.—Persons Required to Make Returns of Income

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6033.—Returns by Exempt Organizations

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6104.—Publicity of Information Required From Certain Exempt Organizations and Certain Trusts

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6652.—Failure to File Certain Information Returns, Registration Statements, Etc.

Questions and answers relating to the reporting and disclosure requirements for political organizations described in § 527. See Rev. Rul. 2000–49, page 430.

Section 6695.— Other Assessable Penalties With Respect to the Preparation of Income Tax Returns for Other Persons

26 CFR 1.6695–2: Preparer due diligence requirements for determining earned income credit eligibility.

T.D. 8905

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

Preparer Due Diligence Requirements for Determining Earned Income Credit Eligibility

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations relating to the due diligence requirements under section 6695(g) of the Internal Revenue Code for paid preparers of Federal income tax returns or claims for refund involving the earned income credit (EIC). These regulations reflect changes to the law made by the Taxpayer Relief Act of 1997. The regulations provide guidance to paid preparers who prepare Federal income tax returns or claims for refund claiming the earned income credit.

DATES: *Effective Date*. These regulations are effective October 17, 2000.

Applicability Date. For dates of applicability, see §1.6695–2(d) of these regulations.

FOR FURTHER INFORMATION CONTACT: Andrea Tucker, (202) 622-4940 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545-1570. This information is required by the IRS to determine preparer due diligence compliance for purposes of the penalty imposed under section 6695(g). 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 control number assigned by the Office of Management and Budget.

The estimated annual burden per recordkeeper varies depending on individual circumstances. The estimated total annual recordkeeping burden: 507,136 hours with the estimated average annual burden hours per recordkeeper: 5 hours 4 minutes (40 minutes per return or claim for refund, 7.6 returns per preparer). The estimated number of recordkeepers: 100,000.

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

Background

Section 6695(g) was added by section 1085(a)(2) of the Taxpayer Relief Act of 1997, Public Law 105–34 (11 Stat. 788, 955 (1997)) (the Act), effective for taxable years beginning after December 31, 1996. Section 6695(g) imposes a $100 penalty for each failure by an income tax return preparer to meet the due diligence requirements set forth in regulations prescribed by the Secretary.

On December 22, 1997, the IRS published Notice 97–65 (1997–2 C.B. 326), in which the IRS set forth the preparer due diligence requirements for 1997 returns and claims for refund involving the EIC. To avoid the imposition of the penalty under section 6695(g) for 1997 returns and claims for refund, Notice 97–65 required preparers to meet four requirements: (1) complete the Earned Income Credit Eligibility Checklist attached to Notice 97–65 (Eligibility Checklist), or otherwise record the information necessary to complete the Eligibility Checklist; (2) complete the Earned Income Credit Worksheet (Computation Worksheet), as contained in the 1997 Form 1040 instructions, or otherwise record the computation and information necessary to complete the Computation Worksheet; (3) not know or have reason to know that any information used by the preparer in determining eligibility for, and the amount of, the EIC is incorrect; and (4) retain for three years the Eligibility Checklist and Computation Worksheet (or alternative records), and a record of how and when the information used to determine eligibility for, and the amount of, the EIC was obtained by the preparer. This information may be retained as a paper record, in magnetic media format, or in an electronic storage media system, consistent with applicable IRS revenue procedures.

On December 21, 1998, temporary regulations (TD 8798, 1999–1 C.B. 804) under section 6695(g) were published in the **Federal Register** (63 F.R. 70339). A notice of proposed rulemaking (REG–120168–97, 1999–1 C.B. 809) cross-referencing the temporary regulations was published in the **Federal Register** (63 F.R. 70357) on that same date. The text of the temporary regulations served as the text of the proposed regulations. The requirements set forth in the temporary regulations were substantially similar to those in Notice 97–65.

The notice of proposed rulemaking solicited comments from the public. One comment was received, but no public hearing was requested or held. After consideration of the comment received, the proposed regulations under section 6695(g) are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

Summary of Comments

The commentator expressed concern that requiring the completion of an eligibility checklist and a computation worksheet impose additional recordkeeping burdens on tax return preparers. The commentator did not suggest alternative due diligence requirements.

The additional recordkeeping required by the regulations is necessary to implement congressional intent with respect to section 6695(g). The legislative history accompanying the Act explains that Congress "believes that more thorough efforts by return preparers are important to improving EIC compliance." H.R. Rep. No. 148, 105th Cong., 1st Sess. 512 (1997) and S. Rep. No. 29, 105th Cong., 1st Sess. 125 (1997). The additional information gathering and recordkeeping required by these regulations are intended to ensure that preparers are thorough when determining whether a taxpayer qualifies to claim the EIC credit. Further, the regulations allow preparers the flexibility to use either the prescribed forms or alternative records containing the same information as the prescribed forms to meet the due diligence requirements.

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. Further, it is hereby certified, pursuant to sections 603(a) and 605(b) of the Regulatory Flexibility Act, that the collection of information in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based upon the fact that the amount of time necessary to record and retain the required information will be nominal for those income tax return preparers that choose to use the Alternative Eligibility Record and Alternative Computation Record. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking that preceded these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

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

* * * * *

Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by removing the entry for "Section 1.6695–2T" and adding an entry in numerical order to read in part as follows:

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

Section 1.6695–2 also issued under 26 U.S.C. 6695(g). * * *

Par. 2. Section 1.6695–2 is added to read as follows:

§1.6695–2 Preparer due diligence requirements for determining earned income credit eligibility.

(a) *Penalty for failure to meet due diligence requirements*. A person who is an income tax return preparer (preparer) of an income tax return or claim for refund under subtitle A of the Internal Revenue Code with respect to determining the eligibility for, or the amount of, the earned income credit (EIC) under section 32 and who fails to satisfy the due diligence requirements of paragraph (b) of this section will be subject to a penalty of $100 for each such failure. However, no penalty will be imposed under section 6695(g) on a person who is an income tax return preparer solely by reason of—

(1) Section 301.7701–15(a)(2) and (b) of this chapter, on account of having given advice on specific issues of law; or

(2) Section 301.7701–15(b)(3) of this chapter, on account of having prepared the return solely because of having prepared another return that affects amounts reported on the return.

(b) *Due diligence requirements*. A preparer must satisfy the following due diligence requirements:

(1) *Completion of eligibility checklist*. (i) The preparer must either—

(A) Complete Form 8867, "Paid Preparer's Earned Income Credit Checklist," or such other form and such other information as may be prescribed by the Internal Revenue Service (IRS)(Eligibility Checklist); or

(B) Otherwise record in the preparer's paper or electronic files the information necessary to complete the Eligibility Checklist (Alternative Eligibility Record). The Alternative Eligibility Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Eligibility Checklist or Alternative Eligibility Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(2) *Computation of credit*. (i) The preparer must either—

(A) Complete the Earned Income Credit Worksheet in the Form 1040 instructions or such other form and such other information as may be prescribed by the IRS (Computation Worksheet); or

(B) Otherwise record in the preparer's paper or electronic files the preparer's EIC computation, including the method and information used to make the computation (Alternative Computation Record). The Alternative Computation Record may consist of one or more documents containing the required information.

(ii) The preparer's completion of the Computation Worksheet or Alternative Computation Record must be based on information provided by the taxpayer to the preparer or otherwise reasonably obtained by the preparer.

(3) *Knowledge*. The preparer must not know, or have reason to know, that any in-

formation used by the preparer in determining the taxpayer's eligibility for, or the amount of, the EIC is incorrect. The preparer may not ignore the implications of information furnished to, or known by, the preparer, and must make reasonable inquiries if the information furnished to, or known by, the preparer appears to be incorrect, inconsistent, or incomplete.

(4) *Retention of records*. (i) The preparer must retain—

(A) A copy of the completed Eligibility Checklist or Alternative Eligibility Record;

(B) A copy of the Computation Worksheet or Alternative Computation Record; and

(C) A record of how and when the information used to complete the Eligibility Checklist or Alternative Eligibility Record and the Computation Worksheet or Alternative Computation Record was obtained by the preparer, including the identity of any person furnishing the information.

(ii) The items in paragraph (b)(4) of this section must be retained for three years after the June 30th following the date the return or claim for refund was presented to the taxpayer for signature, and may be retained on paper or electronically in the manner prescribed in applicable regulations, revenue rulings, revenue procedures, or other appropriate guidance (see §601.601(d)(2) of this chapter).

(c) *Exception to penalty*. The section 6695(g) penalty will not be applied with respect to a particular income tax return or claim for refund if the preparer can demonstrate to the satisfaction of the IRS that, considering all the facts and circumstances, the preparer's normal office procedures are reasonably designed and routinely followed to ensure compliance with the due diligence requirements of paragraph (b) of this section, and the failure to meet the due diligence requirements of paragraph (b) of this section with respect to the particular return or claim for refund was isolated and inadvertent.

(d) *Effective date*. This section applies to income tax returns and claims for refund due on or after October 17, 2000.

§1.6695–2T [Removed]

Par. 3. Section 1.6695–2T is removed.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (b) is amended by removing the entry for "1.6695–2T" and adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.6695–2	1545-1570
* * * * *	

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

Approved October 6, 2000.

Jonathan Talisman,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2000, 65 F.R. 61268)

Part III. Administrative, Procedural, and Miscellanous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 2000–46

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 2000–3, 2000–1 I.R.B. 103, which sets forth areas of the Internal Revenue Code under the jurisdiction of the Associate Chief Counsel in which the Internal Revenue Service will not issue advance rulings or determination letters.

SECTION 2. BACKGROUND

Section 5 of Rev. Proc. 2000–3 sets forth those areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise.

Section 301.7701–1(a)(1) provides that whether an organization is an entity separate from its owners for federal tax purposes is a matter of federal tax law and does not depend on whether the entity is recognized as an entity under local law.

Section 301.7701–1(a)(2) provides that a joint undertaking or other contractual arrangement may create a separate entity for federal tax purposes if the participants carry on a trade, business, financial operation, or venture and divide the profits therefrom. If such an entity is a business entity (i.e., is not a trust) with two or more members, the entity is classified for federal tax purposes either as a partnership or a corporation.

Section 1031(a)(1) provides that no gain or loss shall be recognized on the exchange of property held for productive use in a trade or business or for investment if such property is exchanged solely for property of like kind which is to be held either for productive use in a trade or business or for investment. Sections 1031(a)(2)(B) and 1031(a)(2)(D) provide exceptions from the application of section 1031(a)(1) for stock and interests in a partnership, respectively.

The Service recently has become aware, in part through several requests for advance rulings, that taxpayers are taking the position that certain arrangements where taxpayers acquire undivided fractional interests in real property do not constitute separate entities for federal tax purposes and therefore the fractional interests may be the subject of tax-free exchanges under section 1031(a)(1). The Service intends to study further the facts and circumstances relevant to the determination of whether such arrangements are separate entities for federal tax purposes.

SECTION 3. PROCEDURE

Rev. Proc. 2000–3 is amplified by adding the following to section 5.10.

Section 1031. - Exceptions. - Whether an undivided fractional interest in real property is an interest in an entity that is not eligible for tax-free exchange under section 1031(a)(1).

Section 7701. - Definitions. - Whether arrangements where taxpayers acquire undivided fractional interests in real property constitute separate entities for federal tax purposes.

SECTION 4. EFFECTIVE DATE

This revenue procedure applies to all ruling requests, including any pending in the National Office and any submitted after the date of this publication.

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2000–3 is amplified.

SECTION 6. REQUEST FOR COMMENTS

The Service requests comments concerning this revenue procedure. In particular, comments are requested with respect to the relevance and impact of the following factors to the determination of whether arrangements where taxpayers acquire undivided fractional interests in real property constitute separate entities for federal tax purposes: (1) the terms of any leasing or management agreements entered into with respect to the property and the relationships between the parties to such agreements and the promoter or organizer of the arrangement; (2) the terms of any agreements between the promoter or organizer of the arrangement and the holders of the fractional interests or among the holders of the fractional interests, including any contractual restrictions to which the fractional interests are subject, such as waivers of the right to partition, rights of first refusal, and options to put and/or call the fractional interests; and (3) the overall economics of the arrangements, including the sharing of profits and losses from operating the property as well as of appreciation and depreciation in the value of the property. An original and eight copies of written comments should be sent to:

Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–46)
Room 5228 (PSI:Br1)
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand delivered between the hours of 8 a.m. and 5 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:MSP:R (Rev. Proc. 2000–46)
Room 5228 (PSI:Br1)
1111 Constitution Avenue, NW
Washington, DC

Alternatively, taxpayers may submit comments electronically at: Joel.S.Rutstein@M1.IRSCounsel.treas.gov.

DRAFTING INFORMATION

The principal author of this revenue procedure is Jeanne Sullivan of the Office of the Associate Chief Counsel, Passthroughs & Special Industries. However, other personnel from the IRS and Treasury participated in its development. For further information, contact Jeanne Sullivan at (202) 622-3050 (not a toll-free number).

Part IV. Items of General Interest

Withdrawal of Previous Proposed Rulemaking, Notice of Proposed Rulemaking, and Notice of Public Hearing

Information Reporting Requirements for Certain Payments Made on Behalf of Another Person, Payments to Joint Payees, and Payments of Gross Proceeds From Sales Involving Investment Advisers

REG–246249–96

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of previous notice of proposed rulemaking; notice of proposed rulemaking; and notice of public hearing.

SUMMARY: This document withdraws a previous notice of proposed rulemaking (LR–62–84 [1984–2 C.B. 900]) published May 29, 1984 (49 F.R. 22343). This document contains proposed regulations under section 6041 that clarify who is the payee for information reporting purposes if a check or other instrument is made payable to joint payees, provide information reporting requirements for escrow agents and other persons making payments on behalf of another person, and clarify that the amount to be reported paid is the gross amount of the payment. This document also contains proposed regulations under section 6045 that remove investment advisers from the list of exempt recipients. In addition, this document provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 17, 2001. Requests to speak (with outlines of oral comments) at a public hearing scheduled for February 7, 2001, at 10 a.m. must be submitted by January 24, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–246249–96), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–246249–96), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically via the IRS Internet site at http://www.irs.gov/tax_regs/regslist.html. The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Nancy L. Rose, (202) 622-4910; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Guy R. Traynor, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer,W:CAR:MP:FP:S:O, Washington, DC 20224. Comments on the collection of information should be received by December 19, 2000. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper operation of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in these proposed regulations is in §§1.6041–1(e) and 1.6045–1(c)(3). This information is required to determine if taxpayers have properly reported amounts received as income. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The estimate of the reporting burden in proposed §1.6041–1 is reflected in the burden of Form 1099-MISC, *Miscellaneous Income*, which is currently 14 minutes per form. The estimate of the reporting burden in proposed §1.6045–1 is reflected in the burden of Form 1099-B, *Proceeds of Broker and Barter Exchange Transactions*, which is currently 15 minutes per form.

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

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

Background and Explanation of Provisions

1. *Proposed Regulations Under Section 6041*

Section 6041 provides that all persons engaged in a trade or business that make certain payments in the course of that trade or business to another person of $600 or more in a taxable year must report the amount of the payments and the name and address of the recipient.

Section 3406(a) provides that a payor must withhold tax from reportable payments under certain circumstances, for example, if the payee has failed to furnish

a valid taxpayer identification number to the payor in the manner required. "Reportable payments" include payments that are required to be reported under sections 6041 and 6045. Section 3406(b)(3)(A) and (C). The party that is responsible for reporting the payments under sections 6041 and 6045 is also responsible for any backup withholding required under section 3406.

These proposed regulations address certain issues identified by the Commissioner's Information Reporting Program Advisory Committee (IRPAC) and take into account comments and information provided by IRPAC members representing the banking, real estate, insurance, and securities industries.

a. Payments to Joint Payees

The proposed regulations clarify the definition of fixed and determinable income in §1.6041–1(c) when a payment is made payable to joint payees. This issue was discussed in papers presented at IRPAC meetings in May 1994 and May 1995. The regulations provide that a payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, when a payment in consideration for services is made payable to joint payees, one of whom is the service provider, an information return must be made showing the service provider as the payee if the payment is fixed and determinable income to the service provider, even if the payment is not fixed and determinable income to the other payee. See, e.g., Situation 2 of Rev. Rul. 70–608 (1970–2 C.B. 286).

b. Identification of Payor

A payment reportable under section 6041 may be made by a person on behalf of another person that is the actual source of the funds. Under certain circumstances this so-called middleman, and not the person that provided the funds, is the payor obligated to report the payment under section 6041. See, e.g., Rev. Rul. 93–70 (1993–2 C.B. 294).

Consistent with Rev. Rul. 93–70, the proposed regulations add a new paragraph (e)(1) to §1.6041–1 that provides that a person that makes a payment on behalf of another person and performs a management or oversight function in connection with, or has a significant economic interest in, the payment must report under section 6041. A management or oversight function is an activity that is more than merely administrative or ministerial. For example, a person that merely writes checks at the direction of others in connection with a transaction, sometimes referred to as a paying agent, is performing only an administrative or ministerial function and is not a payor. In contrast, a person that exercises discretion or supervision in connection with a payment is performing a management or oversight function and is a payor. A significant economic interest in a payment is an economic interest that would be compromised if the payment were not made. For example a bank has a significant economic interest in a payment to a contractor when damage occurs to property securing a mortgage held by the bank. With this standard, which was also discussed in the IRPAC papers of May 1994 and May 1995, the proposed regulations attempt to replace disparate revenue rulings with a consistent and easily administrable rule that can be applied to a variety of factual situations involving middlemen.

Section 1.6041–1(e)(2) of the proposed regulations provides an exception to the general rule of §1.6041–1(e)(1) by referencing the procedures in Rev. Proc. 84–33 (1984–1 C.B. 502) for an optional method for payors to designate a paying agent to file information returns and backup withhold.

The proposed regulations include examples, derived primarily from revenue rulings and private letter rulings, which are intended to be all-inclusive. Rulings that are factually encompassed by the proposed regulations will be obsoleted. Comments are requested identifying other factually relevant rulings or suggesting appropriate additional examples.

The proposed regulations make two changes to §1.6041–3 (to be effective January 1, 2001). They revise §1.6041–3(d) to conform the cross-reference to §1.6041–1 to the language effective January 1, 2001, and to clarify the current rule that real estate agents who manage rental property and make payments of rent to landlords are payors and continue to be subject to the general requirements of §1.6041–1. The proposed regulations also remove §1.6041–3(n), which provides an exception to the information reporting requirements of section 6041 for amounts that a bank or similar institution collects on behalf of, and pays over or credits to the account of, the actual owner of the funds, but only if it does not collect the items on a regular and continuing basis. Rev. Rul. 77–53 (1977–1 C.B. 368) further restricted this limitation to banks that collect items on a regular and continuing basis and also assume a management function or perform more than the mere collection and payment or crediting of funds to a customer's account. This holding is consistent with the "management and oversight" standard of the proposed regulations. Accordingly, *Example 11* of the proposed regulations preserves the holding of Rev. Rul. 77–53. Section 1.6041–3(n) is removed to avoid confusion and redundancy. However, its removal will change current requirements by imposing a reporting requirement on a bank that collects and pays or credits funds on behalf of a customer on an infrequent or isolated basis if it performs a management or oversight function in connection with the payment, a transaction that is currently within the §1.6041–3(n) exception.

The proposed regulations also remove paragraphs (b) and (c) of §31.3406(a)–2. These paragraphs provide a standard for information reporting by a so-called middleman that is inconsistent with the standard in the proposed regulations. As amended, §31.3406(a)–2 reiterates the general rule of section 3406(h) (also stated in §35a.9999-3, Q & A 1) that the definition of payor for information reporting purposes determines who is the payor for backup withholding purposes as well.

c. Amount to be Reported When Fees, Expenses or Commissions are Deducted From a Payment

The proposed regulations add a new paragraph (f) to §1.6041– 1 that clarifies that the amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been de-

ducted. See, e.g., Rev. Rul. 67–197 (1967–1 C.B. 319); Rev. Rul. 54–571 (1954–2 C.B. 235). The rule, which applies whether the payment is made jointly or separately to the payee and another person, is also cross-referenced in *Example 6* and *Example 8* of §1.6041–1(e)(3).

The rule of §1.6041–1(f) is illustrated by two examples involving payment of taxable damages by a defendant to a plaintiff. These examples, read with *Example 8* of §1.6041– 1(e)(3), are, in part, inconsistent with *Example 2* of the proposed regulations at §1.6045–5(f), published on May 21, 1999 (64 FR 27730). *Example 2* states that a defendant that pays a settlement to a plaintiff and knows the amount of the plaintiff's attorney fees included in the payment is required to report the payment of the attorney fees under section 6041 and not the gross proceeds under section 6045(f). However, under §1.6041–1(e) of these regulations, the defendant is not exercising management or oversight in connection with, and therefore is not required to make an information return under section 6041 for, the payment to the attorney. The plaintiff, not the defendant, is required to report the payment of attorney fees to plaintiff's attorney under section 6041 (assuming that the payment is made in the course of the plaintiff's trade or business and that the other requirements of section 6041 apply). Accordingly, *Example 2* in the final regulations under section 6045(f) will be revised to provide that the defendant is not required to make an information return under section 6041 but is required to make an information return under section 6045(f), even if the defendant knows the amount of plaintiff's attorney fees.

d. Revenue Rulings to Become Obsolete

As discussed above, the proposed regulations apply to the factual situations addressed in the following revenue rulings, which will become obsolete:
Rev. Rul. 93–70 (1993–2 C.B. 294)
Rev. Rul. 85–50 (1985–1 C.B. 345)
Rev. Rul. 77–53 (1977–1 C.B. 368)
Rev. Rul. 73–232 (1973–1 C.B. 541)
Rev. Rul. 70–608, Situations 1, 2, and 5 (1970–2 C.B. 286)
Rev. Rul. 69–595 (1969–2 C.B. 242)
Rev. Rul. 67–197 (1967–1 C.B. 319)
Rev. Rul. 65–129 (1965–1 C.B. 519)
Rev. Rul. 64–36 (1964–1 C.B. 446)
Rev. Rul. 59–328 (1959–2 C.B. 379)
Rev. Rul. 55–606 (1955–2 C.B. 489)
Rev. Rul. 54–571 (1954–2 C.B. 235)

2. *Proposed Regulations Under Section 6045*

Section 6045 provides that a broker must file an information return showing the name and address of the broker's customer and other details, such as the amount of the gross proceeds of the transaction, as the Secretary may require. Section 6045(c) defines a broker as a dealer, a barter exchange, or any other person who, for a consideration, regularly acts as a middleman with respect to property or services.

Section 1.6045–1(a)(2) provides that a customer is the person who makes a sale effected by a broker, if the broker acts as (i) an agent for the customer in the sale, (ii) a principal in the sale, or (iii) the party in the sale responsible for paying or crediting the proceeds to the customer. Under §1.6045–1(h), a broker must treat the person whose name appears on the broker's books and records as the principal.

Section 5f.6045–1(c)(3), also published as proposed regulations (49 F.R. 22343), provides that no return of information is required with respect to a sale effected for a customer that is an exempt recipient. Among the categories of exempt recipients is a person registered under the Investment Advisers Act of 1940 who regularly acts as a broker (an investment adviser).

Section 5f.6045–1(c)(3)(iii) provides that, in a cash on delivery or similar transaction, only the broker that receives the gross proceeds against delivery of the securities sold is required to report a sale, unless the broker's customer is another broker (a second-party broker) that is an exempt recipient. In that case, only the second-party broker is required to report.

One effect of these provisions is to shift the reporting requirement in a cash on delivery transaction from the broker that receives the gross proceeds against delivery of the securities to an investment adviser. For example, in §5f.6045–1(c)(4) *Example (4)*, an investment adviser instructs a broker/dealer to sell securities owned by the investment adviser's customer and to pay the proceeds of the sale to a custodian bank. The custodian bank is instructed to deliver the securities to the broker/dealer against delivery of the proceeds of the sale. The investment adviser, and not the broker/dealer or the custodian bank, is required to report the payment of the proceeds of the sale to the investment adviser's customer, because (1) the broker/dealer paid the gross proceeds of the sale to the custodian bank against delivery of the securities sold, and (2) the custodian bank's customer was the investment adviser, an exempt recipient.

Commentators on the proposed regulations objected to the imposition of the reporting obligation under section 6045(a) on investment advisers because (1) investment advisers generally do not have first-hand knowledge that a sale has been completed, and (2) investment advisers generally do not handle the proceeds of a sale and, consequently, cannot comply with the backup withholding requirements of section 3406. Investment adviser reporting issues were also the subject of IRPAC papers presented at meetings in November 1995 and October 1997.

These proposed regulations withdraw the 1984 proposed regulations. In general, they propose to incorporate the provisions of §5f.6045–1 into §1.6045–1(c)(3) and (4). The proposed regulations also remove investment advisers from the list of exempt recipients and revise current §5f.6045–1(c)(4) *Examples 4* and *5* to clarify that, under the revised rules, an investment adviser that initiates a sale on behalf of a customer is required to make a return of information only if the sale relates to an investment account in the investment adviser's name (i.e., the identity of the customer is not disclosed to the account custodian).

Proposed Effective Date

The provisions of these regulations under sections 6041 and 3406 are proposed to be applicable for payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations. The provisions of these regulations under section 6045 are proposed to be applicable for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. An initial regulatory flexibility analysis has been prepared for the collection of information in this notice of proposed rulemaking under 5 U.S.C. section 603. The analysis is set forth in this preamble under the heading "Initial Regulatory Flexibility Analysis." Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Initial Regulatory Flexibility Analysis

The collection of information proposed in §1.6041–1(e) is needed to clarify the requirements for filing an information return under section 6041 when a person makes a payment on behalf of another person or to joint payees. The objectives of the proposed regulations are to provide uniform, practicable, and administrable rules under section 6041 for persons making payments on behalf of another person or to joint payees. The types of small entities to which the proposed regulations may apply are small businesses. An estimate of the number of small entities affected is not feasible because of the large variety of entities and transactions to which the proposed regulations may apply. However, in 1997 a total of 73,273,621 Forms 1099-MISC were filed with the IRS. The number of 1997 Forms 1099-MISC that related to transactions that involved payments made on behalf of another person or to joint payees cannot be determined. The current estimated reporting burden relating to Form 1099-MISC is 14 minutes per form. No special professional skills are necessary for preparation of the reports or records. There are no known Federal rules that duplicate, overlap, or conflict with these proposed regulations. The regulations proposed are considered to have the least economic impact on small entities of all alternatives considered.

The collection of information in proposed §1.6045–1(c)(3) will not have a significant economic impact on a substantial number of small entities. The proposed regulations will relieve investment advisers of the requirement to make information returns under section 6045(a), and few, if any, financial custodians that may be affected by the regulations are small entities.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for February 7, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of the preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January 24, 2001. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is Donna M. Crisalli, Office of the Associate Chief Counsel (Income Tax & Accounting). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (LR–62–84) amending 26 CFR part 1 that was published in the **Federal Register** on May 29, 1984 (49 F.R. 22343) is withdrawn. In addition, 26 CFR parts 1, 5f, and 31 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
Section 1.6041–1 also issued under 26 U.S.C. 6041(a). * * *

Par. 2. Section 1.6041–1 is amended by:

1. Removing the language "paragraph (g)" in the second sentence of paragraph (b)(1) and adding the language "paragraph (i)" in its place.

2. Adding two sentences after the fourth sentence of paragraph (c).

3. Redesignating paragraphs (e) through (g) as paragraphs (g) through (i).

4. Adding new paragraphs (e) and (f), and (j).

The additions and revisions read as follows:

§1.6041–1 Return of information as to payments of $600 or more.

* * * * *

(c) * * * A payment made jointly to two or more payees may be fixed and determinable income to one payee even though the payment is not fixed and determinable income to another payee. For example, property insurance proceeds paid jointly to the owner of damaged property and to a contractor that repairs the prop-

erty may be fixed and determinable income to the contractor but not fixed and determinable income to the owner. * * * * * * * *

(e) *Payment made on behalf of another person*—(1) *In general*. A person that makes a payment in the course of its trade or business on behalf of another person is the payor that must make a return of information under this section with respect to that payment if the payment is described in paragraph (a) of this section and, under all the facts and circumstances, that person—

(i) Performs management or oversight functions (i.e., performs more than mere administrative or ministerial functions) in connection with the payment; or

(ii) Has a significant economic interest in the payment.

(2) *Optional method to report*. A person that makes a payment on behalf of another person but is not required to make an information return under paragraph (e)(1) of this section may elect to do so pursuant to the procedures established in Rev. Proc. 84–33 (1984–1 C.B. 502) (optional method for a paying agent to report and deposit amounts withheld for payors under the statutory provisions of backup withholding) (see §601.601(d)(2) of this chapter).

(3) *Examples*. The provisions of this paragraph (e) are illustrated by the following examples:

Example 1. Bank B provides financing to C, a real estate developer, for a construction project. B puts the funds in an escrow account and makes disbursements from the account for labor, materials, services, and other expenses related to the construction project. In connection with the payments, B performs the following functions on behalf of C: approves payments to the general contractor or subcontractors; ensures that loan proceeds are properly applied and that all approved bills are properly paid to avoid mechanics or materialmen's liens; conducts site inspections to determine whether work has been completed (but does not check the quality of the work); evaluates and assesses the cost of the project, including costs of changes; and communicates resulting concerns to C or to the general contractor so that modifications can be made or additional funding obtained. B is performing management or oversight functions in connection with the payment and is subject to the information reporting requirements of section 6041 with respect to payments from the escrow fund.

Example 2. Mortgage company D holds a mortgage on business property owned by E. When the property is damaged by a storm E's insurance company issues a check payable to both D and E in settlement of E's claim. Pursuant to the contract between D and E, D holds the insurance proceeds in an escrow account and makes disbursements according to E's instructions to contractors and subcontractors performing repairs on the property. D is not performing management or oversight functions, but D has a significant economic interest in the payments because the purpose of the arrangement is to ensure that property on which D holds a mortgage is repaired or replaced. D is subject to the information reporting requirements of section 6041 with respect to the payments to contractors.

Example 3. Settlement agent F provides real estate closing services to real estate brokers and agents. F deposits money received from the buyer or lender in an escrow account and makes payments from the account to real estate agents or brokers, appraisers, land surveyors, building inspectors, or similar service providers according to the provisions of the real estate contract and written instructions from the lender. F may also make disbursements pursuant to verbal instructions of the seller or purchaser at closing. F is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041. For the rules relating to F's obligation to report the gross proceeds of the sale, see section 6045(e) and §1.6045–4.

Example 4. Assume the same facts as in *Example 3*, except that the seller instructs F to hire a contractor to perform repairs on the property. F selects the contractor, negotiates the cost, monitors the progress of the project, and inspects the work to ensure it complies with the contract. With respect to the payments to the contractor, F is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 5. Real estate agent G manages certain rental property on behalf of property owner H. In addition to collecting the rent G arranges for various services that are needed to maintain the property (e.g., painting, repairs, lawn mowing, etc.), determines that the services have been satisfactorily performed, and pays the service providers. G is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments to the service providers. With respect to the payments of rent to H, see §1.6041–3(d).

Example 6. Literary agent J receives a payment from publisher L of fees earned by J's client, author K. J deposits the payment into a bank account in J's name and pays K the net amount after subtracting J's commission. From time to time and as directed by K, J also makes payments to attorneys, managers, and other third parties from these funds for services rendered to K. J does not order or direct the provision of services by the third parties to K, and J exercises no discretion in making the payments to them. J is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 in connection with the payments to K or to the third parties. For the rules relating to L's obligation to report the payment of the fees to K, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to K's obligation to report the payment of the commission to J and the payments to the third parties for services, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 7. Attorney P deposits into a client trust fund a settlement payment from R, the defendant in a breach of contract action for lost profits in which P represented plaintiff Q. P makes payments from the client trust fund to service providers such as expert witnesses and private investigators for expenses incurred in the litigation. P decides whom to hire, negotiates the amount of payment, and determines that the services have been satisfactorily performed. In the event of a dispute with a service provider, P withholds payment until the dispute is settled. With respect to payments to the service providers P is performing management or oversight functions and is subject to the information reporting requirements of section 6041.

Example 8. Assume the same facts as in *Example 7*, except that after paying the service providers and deducting his legal fee, P pays Q the remaining funds that P had received from the settlement with R. With respect to the payment to Q, P is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to R's obligation to report the payment of the settlement proceeds to P, see section 6045(f) and §1.6045–5. For the rules relating to R's obligation to report the payment of the settlement proceeds to Q, see paragraphs (a)(1)(i) and (f) of this section. For the rules relating to Q's obligation to report the payment of attorney fees to P, see paragraphs (a)(1)(i) and (d)(2) of this section.

Example 9. Medical insurer S operates as the administrator of a health care program under a contract with a state. S makes payments of government funds to health care providers who provide care to eligible patients. S receives and reviews claims submitted by patients or health care providers, determines if the claims meet all the requirements of the program (e.g., that the care is authorized and that the patients are eligible beneficiaries), and determines the amount of payment. S is performing management or oversight functions and is subject to the information reporting requirements of section 6041 with respect to the payments.

Example 10. Race track employee T holds deposits made by horse owner U in a special escrow account in U's name. U enters into a contract with jockey V to ride U's horse in a race at the track. As directed by U, T pays V the fee for riding U's horse from U's escrow account. T is not performing management or oversight functions and does not have a significant economic interest in the payment, and is not subject to the information reporting requirements of section 6041. For the rules relating to U's obligation to report the payment of the fee to V, see paragraph (a)(1)(i) of this section.

Example 11. Bank W collects payments from mortgagors and remits the amounts to the mortgagees or credits their accounts. W performs no other task with respect to the mortgage payments and has no other interest in the accounts. Although W collects payments on a regular and continuing basis, W is not performing management or oversight functions and does not have a significant economic interest in the payments, and is not subject to the information reporting requirements of section 6041 with respect to the payments.

(f) *Amount to be reported when fees, expenses or commissions are deducted*—(1) *In general*. The amount to be reported as paid to a payee is the gross amount of the payment or payments before fees, commissions, expenses, or other amounts owed by the payee to another person have been deducted, whether the payment is made jointly or separately to the payee and the other person.

(2) *Examples*. The provisions of this paragraph (f) are illustrated by the following examples:

Example 1. Attorney P represents client Q in a breach of contract action for lost profits against defendant R. R settles the case for $100,000 damages and $40,000 for attorney fees. R issues a check payable to P and Q in the amount of $140,000. R is required to make an information return reporting a payment to Q in the amount of $140,000.

Example 2. Assume the same facts as in *Example 1*, except that R issues a check to Q for $100,000 and a separate check to P for $40,000. R is required to make an information return reporting a payment to Q in the amount of $140,000.

* * * * *

(j) *Effective date*. The provisions of paragraphs (b), (c), (e), and (f) apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§1.6041–3 [Amended]

Par. 3. Section 1.6041–3, as in effect on January 1, 2001, is amended as follows:

1. In paragraph (d), removing the language "(but the agent is subject to the requirements of paragraph (a)(1)(ii) and (2)(ii) of §1.6041–1)" and adding the language "(but the agent is required to report payments of rent to the landlord in accordance with §1.6041–1)(a)(1)(i)(B) and (2)" in its place.

2. Removing paragraph (n) and redesignating paragraphs (o) through (q) as paragraphs (n) through (p).

Par. 4. Section 1.6045–1, as in effect on January 1, 2001, is amended as follows:

1. Revising paragraph (a) introductory text.

2. Revising paragraphs (c)(3) and (c)(4).

3. Removing the language "5f.6045–1 (c)(3)(ii) of this chapter" and adding the language "paragraph (c)(3)(iii) of this section" in its place in each place it appears in paragraph (g)(4) *Examples 1*, *4*, *5*, *6*, and *7*(i).

The revisions read as follows:

§1.6045–1 Returns of information of brokers and barter exchanges.

(a) *Definitions*. The following definitions apply for purposes of this section and §1.6045–2:

* * * * *

(c) * * *

(3) *Exceptions*—(i) *Sales effected for exempt recipients*— (A) *In general*. No return of information is required with respect to a sale effected for a customer that is an exempt recipient under paragraph (c)(3)(i)(B) of this section.

(B) *Exempt recipient defined*. The term *exempt recipient* means—

(*1*) A corporation as defined in section 7701(a)(3), whether domestic or foreign;

(*2*) An organization exempt from taxation under section 501(a) or an individual retirement plan;

(*3*) The United States or a State, the District of Columbia, a possession of the United States, a political subdivision of any of the foregoing, a wholly-owned agency or instrumentality of any one or more of the foregoing, or a pool or partnership composed exclusively of any of the foregoing;

(*4*) A foreign government, a political subdivision thereof, an international organization, or any wholly-owned agency or instrumentality of the foregoing;

(*5*) A foreign central bank of issue as defined in §1.895–1(b)(1) (i.e., a bank that is by law or government sanction the principal authority, other than the government itself, issuing instruments intended to circulate as currency);

(*6*) A dealer in securities or commodities registered as such under the laws of the United States or a State;

(*7*) A futures commission merchant registered as such with the Commodity Futures Trading Commission;

(*8*) A real estate investment trust (as defined in section 856);

(*9*) An entity registered at all times during the taxable year under the Investment Company Act of 1940 (15 U.S.C. 80a-1, *et seq.*);

(*10*) A common trust fund (as defined in section 584(a)); or

(*11*) A financial institution such as a bank, mutual savings bank, savings and loan association, building and loan association, cooperative bank, homestead association, credit union, industrial loan association or bank, or other similar organization.

(C) *Exemption certificate*. A broker may treat a person described in paragraph (c)(3)(i)(B) of this section as an exempt recipient based on a properly completed exemption certificate (as provided in §31.3406(h)–3) of this chapter or on the broker's actual knowledge that the payee is a person described in paragraph (c)(3)(i)(B) of this section. A broker may require an exempt recipient to file a properly completed exemption certificate and may treat an exempt recipient that fails to do so as a recipient that is not exempt.

(ii) *Excepted sales*. No return of information is required with respect to a sale effected by a broker for a customer if the sale is an excepted sale. For this purpose, a sale is an excepted sale if it is so designated by the Internal Revenue Service in a revenue ruling or revenue procedure (see §601.601(d)(2) of this chapter).

(iii) *Multiple brokers*. If a broker is instructed to initiate a sale by a person that is an exempt recipient described in paragraph (c)(3)(i)(B)(*6*), (*7*), or (*11*) of this section, no return of information is required with respect to the sale by that broker. In a redemption of stock or retirement of securities, only the broker responsible for paying the holder redeemed or retired, or crediting the gross proceeds on the sale to that holder's account, is required to report the sale.

(iv) *Cash on delivery transactions*. In the case of a sale of securities through a cash on delivery account, a delivery versus payment account, or other similar account or transaction, only the broker that receives the gross proceeds from the sale against delivery of the securities sold is required to report the sale. If, however, the broker's customer is another broker (second-party broker) that is an exempt recipient, then only the second-party broker is required to report the sale.

(v) *Fiduciaries and partnerships*. No return of information is required with respect to a sale effected by a custodian or trustee in its capacity as such or a redemption of a partnership interest by a partnership provided the sale is otherwise reported by the custodian or trustee on a properly filed Form 1041, or the redemp-

tion is otherwise reported by the partnership on a properly filed Form 1065, and all Schedule K-1 reporting requirements are satisfied.

(vi) *Sales at issue price*. No return of information is required with respect to a sale of an interest in a regulated investment company (within the meaning of section 851) that computes its current price per share for purposes of distributions, redemptions, and purchases so as to stabilize the price per share at a constant amount that approximates its issue price or the price at which it was originally sold to the public.

(vii) *Obligor payments on certain obligations*. No return of information is required with respect to payments representing obligor payments on—

(A) Nontransferable obligations (including savings bonds, savings accounts, checking accounts, and NOW accounts);

(B) Obligations as to which the entire gross proceeds are reported by the broker on Form 1099 under provisions of the Internal Revenue Code other than section 6045 (including stripped coupons issued prior to July 1, 1982); or

(C) Retirement of short-term obligations (i.e., obligations with a fixed maturity date not exceeding 1 year from the date of issue) that have original issue discount, as defined in section 1273(a)(1).

(viii) *Callable obligations*. No return of information is required with respect to payments representing obligor payments on demand obligations that also are callable by the obligor and that have no premium or discount.

(ix) *Foreign currency*. No return of information is required with respect to a sale of foreign currency other than a sale pursuant to a forward contract or regulated futures contract that requires delivery of foreign currency.

(x) *Fractional share*. No return of information is required with respect to a sale of a fractional share of stock if the gross proceeds on the sale of the fractional share are less than $20.

(xi) *Certain retirements*. No return of information is required from an issuer or its agent with respect to the retirement of book entry or registered form obligations as to which the relevant books and records indicate that no interim transfers have occurred.

(xii) *Cross reference*. For an exception for certain sales of agricultural commodities and certificates issued by the Commodity Credit Corporation after January 1, 1993, see paragraph (c)(7) of this section.

(xiii) *Effective date*. The provisions of this paragraph (c)(3) apply for sales effected on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations.

(4) *Examples*. The following examples illustrate the application of the rules in paragraph (c)(3) of this section:

Example 1. P, an individual who is not an exempt recipient, places an order with B, a person generally known in the investment community to be a federally registered broker/dealer, to sell P's stock in a publicly traded corporation. B, in turn, places an order to sell the stock with C, a second broker, which will execute the sale. B discloses to C the identity of the customer placing the order. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 2. Assume the same facts as in *Example 1* except that B has an omnibus account with C so that B does not disclose to C whether the transaction is for a customer of B or for B's own account. C is not required to make a return of information with respect to the sale because C was instructed by B, an exempt recipient as defined in paragraph (c)(3)(i)(B)(6) of this section, to initiate the sale. B is required to make a return of information with respect to the sale because P is B's customer and is not an exempt recipient.

Example 3. D, an individual who is not an exempt recipient, enters into a cash on delivery stock transaction by instructing K, a federally registered broker/dealer, to sell stock owned by D, and to deliver the proceeds to L, a custodian bank. Concurrently with the above instructions, D instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to this transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 4. Assume the same facts as in *Example 3* except that E, a federally registered investment adviser, instructs K to sell stock owned by D and to deliver the proceeds to L. Concurrently with the above instructions, E instructs L to deliver D's stock to K (or K's designee) against delivery of the proceeds from K. The records of both K and L with respect to the transaction show an account in the name of D. Pursuant to paragraph (h)(1) of this section, D is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because D is L's customer and is not an exempt recipient.

Example 5. Assume the same facts as in *Example 4* except that the records of both K and L with respect to the transaction show an account in the name of E. Pursuant to paragraph (h)(1) of this section, E is considered the customer of K and L. Under paragraph (c)(3)(iv) of this section, K is not required to make a return of information with respect to the sale because K will pay the gross proceeds to L against delivery of the securities sold. L is required to make a return of information with respect to the sale because E is L's customer and is not an exempt recipient. E is required to make a return of information with respect to the sale because D is E's customer and is not an exempt recipient.

Example 6. F, an individual who is not an exempt recipient, owns bonds that are held by G, a federally registered broker/dealer, in an account for F with G designated as nominee for F. Upon the retirement of the bonds, the gross proceeds are automatically credited to the account of F. G is required to make a return of information with respect to the retirement because G is the broker responsible for making payments of the gross proceeds to F.

* * * * *

§1.6045–2 [Amended]

Par. 5. In §1.6045–2, paragraph (b)(2)(ii), is amended by removing the language "§5f.6045–1(c)(3)(i)(B) of the Temporary Income Tax Regulations under the Tax Equity and Fiscal Responsibility Act of 1982" and adding the language "§1.6045– 1(c)(3)(i)(B)" in its place.

Par. 6. In §1.6049–4, as in effect on January 1, 2001, paragraph (a)(2) is revised to read as follows:

§1.6049–4 Return of information as to interest paid and original issue discount includible in gross income after December 31, 1982.

(a) * * *

(2) *Payor*. For payments made on or after the beginning of the first calendar year that begins after the date these regulations are published in the **Federal Register** as final regulations, a payor is a person described in paragraph (a)(2)(i) or (ii) of this section.

(i) Every person who makes a payment of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter) to any other person during a calendar year.

(ii) Every person who collects on behalf of another person payments of the type and of the amount subject to reporting under this section (or under an applicable section under this chapter), or who otherwise acts as a middleman (as defined in paragraph (f)(4) of this section) with respect to such payment.
* * * * *

PART 5f—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX EQUITY AND FISCAL RESPONSIBILITY ACT OF 1982

Par. 7. The authority citation for part 5f is amended by removing the authority citation for Sec. 5f.6045–1 to read in part as follows:

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

§5f.6045–1 [Removed]

Par. 8. Section 5f.6045–1 is removed.

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Par. 9. The authority citation for part 31 continues to read in part as follows:

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

Par. 10. Section 31.3406–0 is amended by:

1. Revising the entry for §31.3406(a)–2, paragraph (b).

2. Adding an entry for §31.3406(a)–2, paragraph (d).

The revision and addition read as follows:

§31.3406–0 Outline of the backup withholding regulations.

* * * * *

§31.3406(a)–2 Definition of payors obligated to backup withhold.

* * * * *

(b) Persons treated as payors.
* * * * *

(d) Effective date.
* * * * *

Par. 11. Section 31.3406(a)–2 is revised to read as follows:

§31.3406(a)–2 Definition of payors obligated to backup withhold.

(a) *In general*. *Payor* means the person that is required to make an information return under section 6041, 6041A(a), 6042, 6044, 6045, 6049, 6050A, or 6050N, with respect to any reportable payment (as described in section 3406(b)), or that is described in paragraph (b) of this section.

(b) *Persons treated as payors*. The following persons are treated as payors for purposes of section 3406—

(1) A grantor trust established after December 31, 1995, all of which is owned by two or more grantors, and for this purpose spouses filing a joint return are considered to be one grantor;

(2) A grantor trust with ten or more grantors established on or after January 1, 1984 but before January 1, 1996;

(3) A common trust fund; and

(4) A partnership or an S corporation that makes a reportable payment.

(c) *Persons not treated as payors*. The following persons are not treated as payors for purposes of section 3406 if the person does not have a reporting obligation under the section on information reporting to which the payment relates—

(1) A trust (other than a grantor trust as described in paragraph (b)(1) or (2) of this section) that files a Form 1041 containing information required to be shown on an information return, including amounts withheld under section 3406; or

(2) A partnership making a payment of a distributive share or an S corporation making a similar distribution.

(d) *Effective date*. The provisions of this section apply to payments made on or after the beginning of the first calendar year that begins after these regulations are published in the **Federal Register** as final regulations.

§31.3406(a)–4 [Amended]

Par. 12. Section 31.3406(a)–4 is amended as follows:

1. In paragraph (c)(1), first sentence, removing the language "Any middleman (as defined in §31.3406(a)–2(b))" and adding the language "A middleman payor (as defined in §31.3406(a)–2(b) or in the section on information reporting to which the payment relates)" in its place.

2. In paragraph (c)(3), first sentence, removing the language "§31.3406(a)–2(b)(4)" and adding the language "§31.3406(a)–2(b)(1) or (2)" in its place.

§31.3406(b)(3)–2 [Amended]

Par. 13. In §31.3406(b)(3)–2, paragraph (b)(5) is amended by removing the language "§5f.6045–1(c)(3)(ix)" and adding the language "§1.6045–1(c)(3)(x)" in its place.

§31.3406(d)–4 [Amended]

Par. 14. In §31.3406(d)–4, paragraph (a)(1) introductory text is amended by removing the language "the payor of the instrument (as defined in §31.3406(a)–2(b)(3))," and adding the language "a broker holding a security (including stock) for a customer in street name," in its place.

§31.3406(h)–1 [Amended]

Par. 15. In §31.3406(h)–1, paragraph (c), second sentence, is amended by removing the language "§5f.6045–1(c)(3)(ii) and (iii)" and adding the language "§1.6045–1(c)(3)(iii) and (iv)" in its place.

§31.3406(h)–2 [Amended]

Par. 16. Section 31.3406(h)–2 is amended as follows:

1. In paragraph (c), third sentence, removing the language "with two or more grantors described in §31.3406(a)–2(b)(4), which is treated as a middleman payor" and adding the language "described in §31.3406(a)–2(b)(1) or (2), which is treated as a payor" in its place.

2. In paragraph (d), first sentence, removing the language "A middleman payor (as defined in §31.3406(a)–2(b)" and adding the language "A middleman payor (as defined in §31.3406(a)–2(b) or in the section on information reporting to which the payment relates)" in its place.

3. In paragraph (f)(6), removing the language "§31.3406(a)– 2(a)" and adding the language "§31.3406(a)–2" in its place.

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 16, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 17, 2000, 65 F.R. 61292)

Notice of Proposed Rulemaking and Notice of Public Hearing

Exclusion of Gain From Sale or Exchange of a Principal Residence

REG–105235–99

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the exclusion of gain from the sale or exchange of a taxpayer's principal residence. These proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, as amended by the Internal Revenue Service Restructuring and Reform Act of 1998. These proposed regulations generally affect taxpayers who sell or exchange their principal residences.

DATES: Written or electronically generated comments must be received by January 9, 2001. Requests to speak (with outlines of oral comments) to be discussed at the public hearing scheduled for January 23, 2001 at 10 a.m., must be submitted by January 3, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–105235–99), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–105235–99), Courier's Desk, Internal Revenue Service, 1111 Constitution Ave., NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.gov/tax_regs/regslist.html. The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Service Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Sara P. Shepherd, (202) 622-4910; concerning submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, contact Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

1. *Section 121 Exclusion*

This document contains proposed amendments to the Income Tax Regulations (26 CFR part 1) under section 121 of the Internal Revenue Code relating to the exclusion of gain from the sale or exchange of a taxpayer's principal residence. These proposed regulations reflect changes to the law made by the Taxpayer Relief Act of 1997, Public Law 105–34 (111 Stat. 788 (TRA 1997)), as amended by the Internal Revenue Service Restructuring and Reform Act of 1998, Public Law 105–206 (112 Stat. 805 (RRA 1998)).

Prior to the repeal by TRA 1997, section 1034 provided that gain from the sale or exchange of a principal residence (old residence) was recognized only to the extent that the taxpayer's adjusted sales price of the old residence exceeded the taxpayer's cost of purchasing a new residence within the replacement period (generally 2 years before or after the date of sale).

Prior to amendment by TRA 1997, former section 121 provided that a taxpayer could make a one-time election to exclude up to $125,000 of gain from the sale or exchange of property. To qualify for the exclusion, the taxpayer must have (1) been age 55 or older on the date of the sale or exchange, and (2) owned and used the property as the taxpayer's principal residence for at least 3 years during the 5-year period ending on the date of the sale or exchange.

TRA 1997 amended section 121 and repealed section 1034 for sales and exchanges of principal residences after May 6, 1997 (except, at the election of the taxpayer, to a sale or exchange (1) made on or before August 5, 1997, (2) made pursuant to a binding contract in effect on August 5, 1997, or (3) that would qualify under section 1034 by reason of a new residence acquired on or before August 5, 1997 or pursuant to a binding contract in effect on August 5, 1997). Under section 121 as amended, a taxpayer generally excludes up to $250,000 ($500,000 for certain joint returns) of gain realized on the sale or exchange of property if the property was owned and used as the taxpayer's principal residence for at least 2 years during the 5-year period ending on the date of the sale or exchange. The exclusion applies regardless of the age of the taxpayer, and the full exclusion can be used only once every 2 years. A taxpayer who fails to meet these requirements by reason of a change in place of employment, health, or, to the extent provided in regulations, unforeseen circumstances may be entitled to a reduced exclusion.

RRA 1998 amended TRA 1997 to clarify that the reduced exclusion amount under section 121(c) is a portion of the maximum limitation amount ($250,000 or $500,000 for certain joint returns), not a portion of the realized gain. See H.R. Rep. No. 356, 105th Cong., 1st Sess. 17 (1997); S. Rep. No. 174, 105th Cong., 2d Sess. 150 (1998). In addition, the amendments provided that for married taxpayers filing jointly but failing to meet the ownership, use, or timing requirements of section 121(b)(2)(A), the maximum limitation amount will be the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. S. Rep. No. 174, 105th Cong., 2d Sess. 151 (1998); H.R. Conf. Rep. No. 599, 105th Cong., 2d Sess. 337 (1998). Lastly, the amendments clarified that a taxpayer may elect to apply prior law under section 1034 or former section 121 to a sale or exchange occurring on as well as before the date of enactment, August 5, 1997. H.R. Rep. No. 356, 105th Cong., 1st Sess. 18 (1997); S. Rep. No. 174, 105th Cong., 2d Sess. 151 (1998).

2. *Section 121 Exclusion in Individuals' Title 11 Cases*

This document also contains proposed amendments to the Income Taxation Regulations (26 CFR part 1) under section 1398 of the Internal Revenue Code. Under the authority provided in section 1398(g)(8), the regulations add the section 121 exclusion to the list of tax attributes of the debtor that the bankruptcy estate of an individual in a chapter 7 or 11 bankruptcy case under title 11 of the United States Code succeeds to and takes into account in computing the taxable income of the estate. Although these regulations are proposed to be applicable on or after the date they are published as final regulations in the **Federal Register**, in view of the IRS's acquiescence in the case

of *Internal Revenue Service v. Waldschmidt (In re Bradley)*, AOD CC-1999-009 (August 30, 1999), and Chief Counsel Notice (35)000-162 (August 10, 1999), the IRS will not challenge the position taken prior to the effective date of these regulations that a bankruptcy estate may use the section 121 exclusion if the debtor would otherwise satisfy the section 121 requirements.

Explanation of Provisions

1. *Section 121 Exclusion*

Section 1.121–1(b) of the proposed regulations addresses the definition of principal residence. This section provides that whether or not property is the taxpayer's residence, and whether or not property is used by the taxpayer as the taxpayer's principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances. If a taxpayer alternates between two properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year will ordinarily be considered the taxpayer's principal residence.

Section 1.121–1(c) of the proposed regulations addresses the use requirement under section 121(a). This section provides that, in order for a taxpayer to satisfy the use requirement under section 121(a), the taxpayer must occupy the residence (except for short temporary absences) for at least 2 years during the 5-year period ending on the date of the sale or exchange. See H.R. Rep. No. 148, 105th Cong., 1st Sess. at 348 (1997); S. Rep. No. 33, 105th Cong., 1st Sess. at 37 (1997); H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. at 386 (1997).

Section 1.121–1(d) provides that the section 121 exclusion does not apply to so much of the gain from the sale or exchange of property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of the property.

Section 1.121–1(e) of the proposed regulations provides that if a taxpayer satisfies the use requirement only with respect to a portion of the property sold or exchanged, section 121 will apply only to the gain from the sale or exchange allocable to that portion. Thus, if the residence was used partially for residential purposes and partially for business purposes, only that part of the gain allocable to the residential portion is excludable under section 121. Furthermore, the section 121 exclusion does not apply to the extent that depreciation attributable to periods after May 6, 1997, exceeds gain allocable to the business-use portion of the property.

Under section 121(c), a reduced exclusion is available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in section 121(a) or the 2-year limitation described in section 121(b)(3). Section 1.121–3(a) of the proposed regulations provides that the reduced exclusion applies only if the sale or exchange is necessitated by a change in place of employment, health, or, to the extent provided in forms, instructions, or other appropriate guidance including regulations and letter rulings, unforeseen circumstances. The IRS and the Treasury Department request written comments regarding what should qualify as an unforeseen circumstance for purposes of determining whether a taxpayer is eligible to claim the reduced exclusion available under section 121(c).

Under section 121(d)(8), a taxpayer must make an election to have the section 121 exclusion apply to a sale or exchange of a remainder interest in the taxpayer's principal residence. Section 1.121–4(f)(3) provides that the taxpayer makes the election by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the remainder interest in the taxpayer's gross income.

Under section 121(f), a taxpayer must make an election to have the section 121 exclusion not apply to a sale or exchange of the taxpayer's principal residence. Section 1.121–4(h) provides that the taxpayer makes the election by filing a return for the taxable year of the sale or exchange that includes the gain from the sale or exchange of the residence in the taxpayer's gross income.

2. *Section 121 Exclusion in Individuals' Title 11 Cases*

Section 1.1398–3 of the proposed regulations provides that the bankruptcy estate of an individual in a chapter 7 or 11 bankruptcy case under title 11 of the United States Code succeeds to and takes into account the individual's section 121 exclusion if the individual satisfies the requirements of section 121.

3. *Proposed Effective Date*

These regulations are proposed to be applicable for sales or exchanges that occur on or after the date they are published as final regulations in the **Federal Register**.

Special Analyses

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

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any electronic or written comments (a signed original and eight (8) copies of written comments) that are submitted timely (in the manner described in the ADDRESSES caption) to the IRS. The IRS and Treasury request comments on the clarity of the proposed rules and how they may be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 23, 2001, beginning at 10 a.m. in the IRS Auditorium, Seventh Floor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the 10th Street entrance, located between Constitution and Pennsylvania Avenues, NW. In addition, all visitors must present photo identification to

enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 15 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of the preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by January 3, 2001. A period of 10 minutes will be allotted to each person making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.1398–3 also issued under 26 U.S.C. 1398(g).

Par. 2. Sections 1.121–1, 1.121–2, 1.121–3 and 1.121–4 are revised to read as follows:

§1.121–1 Exclusion of gain from sale or exchange of a principal residence.

(a) *In general*. Section 121 provides that, under certain circumstances, gross income does not include gain realized on the sale or exchange of property that was owned and used by a taxpayer as the taxpayer's principal residence. Subject to the other provisions of section 121, a taxpayer will exclude gain only if, during the 5-year period ending on the date of the sale or exchange, the taxpayer owned and used the property as the taxpayer's principal residence for periods aggregating 2 years or more.

(b) *Principal residence*. Whether or not property is used by the taxpayer as the taxpayer's residence, and whether or not property is used by the taxpayer as the taxpayer's principal residence (in the case of a taxpayer using more than one property as a residence), depends upon all the facts and circumstances. If a taxpayer alternates between two properties, using each as a residence for successive periods of time, the property that the taxpayer uses a majority of the time during the year will ordinarily be considered the taxpayer's principal residence. A property used by the taxpayer as the taxpayer's principal residence may include a houseboat, a house trailer, or stock held by a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)), if the dwelling that the taxpayer is entitled to occupy as a stockholder is used by the taxpayer as the taxpayer's principal residence. Property used by the taxpayer as the taxpayer's principal residence does not include personal property, that is not a fixture under local law.

(c) *Ownership and use requirements*. The requirements of ownership and use for periods aggregating 2 years or more may be satisfied by establishing ownership and use for 24 full months or for 730 days (365 x 2). The requirements of ownership and use may be satisfied during nonconcurrent periods if both the ownership and use tests are met during the 5-year period ending on the date of the sale or exchange. In establishing whether a taxpayer has satisfied the 2-year use requirement, occupancy of the residence is required. However, short temporary absences, such as for vacation or other seasonal absence (although accompanied with rental of the residence), are counted as periods of use.

(d) *Depreciation taken after May 6, 1997*. The section 121 exclusion does not apply to so much of the gain from the sale or exchange of property as does not exceed the portion of the depreciation adjustments (as defined in section 1250(b)(3)) attributable to periods after May 6, 1997, in respect of the property.

(e) *Property used in part as a principal residence*. If a taxpayer satisfies the use requirement only with respect to a portion of the property sold or exchanged, section 121 will apply only to the gain from the sale or exchange allocable to that portion. Thus, if the residence was used partially for residential purposes and partially for business purposes, only that part of the gain allocable to the residential portion is excludable under section 121. Furthermore, the section 121 exclusion does not apply to the extent that depreciation attributable to periods after May 6, 1997, exceeds gain allocable to the business-use portion of the property. See *Example 8* in paragraph (f) of this section.

(f) *Examples*. The provisions of paragraphs (a) through (e) of this section are illustrated by the following examples:

Example 1. Taxpayer A has owned and used his house as his principal residence since 1986. On January 1, 1998, A moves to another state. A leases his house from that date until April 18, 2000, when he sells it. A is eligible for the section 121 exclusion because he has owned and used the house as his principal residence for at least 2 years out of the 5 years preceding the sale.

Example 2. Taxpayer B owned and used a house as her principal residence from 1986 to the end of 1997. On January 1, 1998, B moved to another state and ceases to use the house. B's move was not necessitated by a change in place of employment, health, or unforeseen circumstances. B's son moved into the house in March 1999 and used the residence until it was sold on July 1, 2001. Taxpayer B may not exclude gain from the sale under section 121 because she did not use the property as her principal residence for at least 2 years out of the 5 years preceding the sale.

Example 3. Taxpayer C lived in a townhouse that he rented from 1993 through 1997. On January 1, 1998, he purchased this townhouse. On February 1, 1998, C moved into his daughter's home. On March 1, 2000, while still living in his daughter's home, C sold his townhouse. The section 121 exclusion will apply to gain from the sale because C owned the townhouse for at least 2 years out of the 5 years preceding the sale (from January 1, 1998 until March 1, 2000) and he used the townhouse as his principal residence for at least 2 years during the 5-year period preceding the sale (from March 1, 1995 until February 1, 1998).

Example 4. Taxpayer D, a college professor, purchased and moved into a house on May 1, 1997. He used the house as his principal residence continuously until September 1, 1998, when he went abroad for a 1-year sabbatical leave. On October 1, 1999, 1 month after returning from the leave, D sold the house. Because his leave is not considered to be a short temporary absence for purposes of section 121 (see paragraph (c) of this section), the period of

the leave may not be included in determining whether D used the house for periods aggregating 2 years during the 5-year period ending on the date of the sale. Consequently, D is not entitled to exclude gain under section 121 because he did not use the residence for the requisite period.

Example 5. Taxpayer E purchased a house on February 1, 1998, that he used as his principal residence. During 1998 and 1999, E left his residence for a 2-month summer vacation. E sold the house on March 1, 2000. Although, in the 5-year period preceding the date of sale, the total time E used his residence is less than 2 years (21 months), the section 121 exclusion will apply to gain from the sale of the residence because the 2-month vacations are short temporary absences and are counted as periods of use in determining whether E used the residence for the requisite period.

Example 6. On July 1, 1999, Taxpayer F moves into a house that he owns and had rented to tenants since July 1, 1997. F took depreciation deductions totaling $14,000 for the period that he rented the property. After using the residence as his principal residence for 2 full years, F sells the property on August 1, 2001. F's gain realized from the sale is $40,000. F had no capital losses for 2001. Only $26,000 ($40,000 gain realized - $14,000 depreciation deductions) may be excluded under section 121. The $14,000 of gain recognized by F is unrecaptured section 1250 gain within the meaning of section 1(h).

Example 7. Taxpayer G, an attorney, uses a portion of her principal residence as a law office for a period in excess of 3 years out of the 5 years preceding the sale of the property. Because G did not use the law office portion of the property as her residence, the section 121 exclusion does not apply to the gain from the sale that is allocable to the law office portion of the property.

Example 8. Taxpayer H buys a house in 1998. For 5 years, H uses a portion of the property as his principal residence and a portion of the property for business purposes. H claims depreciation deductions of $20,000 for the business use of the property. H sells the property in 2003, realizing a gain of $50,000. H had no other section 1231 or capital gains or losses for 2003. H determines that $15,000 of the gain is allocable to the business-use portion of the property and that $35,000 of the gain is allocable to the portion of the property used as his residence. H must recognize $15,000 of the gain allocable to the business-use portion of the property. This $15,000 of gain is unrecaptured section 1250 gain within the meaning of section 1(h). In addition, the section 121 exclusion does not apply to the extent that H's post-May 6, 1997 depreciation ($20,000) exceeds the gain allocable to the business-use portion of the property ($15,000). Therefore, H may exclude $30,000 of the gain from the sale of the property. The remaining $5,000 of gain is recognized by H as unrecaptured section 1250 gain within the meaning of section 1(h).

Example 9. Taxpayer J buys a house in 1998. For 5 years, J uses a portion of the property as her principal residence and a portion of the property for business purposes. J claims depreciation deductions of $10,000 for the business use of the property. J sells the property in 2003, realizing a gain of $50,000. J had no other section 1231 or capital gains or losses for 2003. J determines that $15,000 of the gain is allocable to the business-use portion of the property and that $35,000 of the gain is allocable to the portion of the property used as her residence. J must recognize the $15,000 of gain allocable to the business-use portion of the property ($10,000 of which is unrecaptured section 1250 gain within the meaning of section 1(h), and $5,000 of which adjusted net capital gain). J may exclude $35,000 of the gain from the sale of the property.

Example 10. Taxpayer K owns two residences, one in New York and one in Florida. From 1999 through 2003, he lives in the New York residence for 7 months and the Florida residence for 5 months. Thus, K used the New York residence a majority of the time in each year from 1999 through 2003. Therefore, in the absence of facts and circumstances indicating otherwise, the New York residence is his principal residence, and only the New York residence would be eligible for the 121 exclusion if it were sold at the end of 2003.

Example 11. Taxpayer L owns two residences, one in Virginia and one in Maine. During 1999 and 2000, she lives in the Virginia residence. During 2001 and 2002, L lives in the Maine residence. During 2003, she lives in the Virginia residence. Her principal residence during 1999, 2000, and 2003 is the Virginia residence. Her principal residence during 2001 and 2002 is the Maine residence. Either residence would be eligible for the 121 exclusion if it were sold during 2003.

(g) *Effective date*. This section and §§1.121–2 through 1.121–4 are applicable for sales and exchanges that occur on or after the date these regulations are published as final regulations in the **Federal Register**.

§1.121–2 Limitations.

(a) *Dollar limitations*. A taxpayer may exclude from gross income up to $250,000 of gain from the sale or exchange of the taxpayer's principal residence. If taxpayers jointly own a principal residence but file separate returns, each taxpayer will exclude from gross income up to $250,000 of gain that is attributable to each taxpayer's interest in the property, if the requirements of section 121 have otherwise been met.

(b) *Special rules for joint returns*—(1) *In general*. A husband and wife who make a joint return for the year of the sale or exchange may exclude up to $500,000 of gain if—

(i) Either spouse meets the 2-year ownership requirements of §1.121–1(a);

(ii) Both spouses meet the 2-year use requirements of
§1.121–1(a); and

(iii) Neither spouse excluded gain from a prior sale or exchange of property under section 121 within the last 2 years (as determined under paragraph (c) of this section).

(2) *Other joint returns*. For taxpayers filing jointly, if the spouses fail to meet the requirements of paragraph (b)(1) of this section, the maximum limitation amount to be claimed by the couple will be the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. For this purpose, each spouse will be treated as owning the property during the period that either spouse owned the property.

(3) *Examples*. The provisions of this paragraph (b) are illustrated by the following examples:

Example 1. Married taxpayers H and W sell their residence and the gain realized from the sale is $256,000. H and W meet the requirements of section 121 and file a joint return for the year of the sale. The entire amount of gain from the sale of their principal residence is excluded from gross income because the gain realized from the sale does not exceed the limitation amount of $500,000 available to taxpayers filing a joint return.

Example 2. During 1999, married taxpayers H and W each sell a residence that each had separately owned and used as a principal residence before their marriage. Each spouse meets the ownership and use tests for his or her respective residence. Neither spouse meets the use requirement for the other spouse's residence. H and W file a joint return for the year of the sales. The gain realized from the sale of H's residence is $200,000. The gain realized from the sale of W's residence is $300,000. Because the ownership and use requirements are met for each residence by each respective spouse, H and W are eligible to exclude up to $250,000 of gain from the sale of each of their residences. However, W may not use H's unused exclusion to exclude gain in excess of her exclusion amount. Therefore, H and W must recognize $50,000 of the gain realized on the sale of W's residence.

Example 3. Married taxpayers H and W sell their residence and file a joint return for the year of the sale. Section 1.121– 3 (relating to the reduced exclusion) does not apply to the sale of their residence. W, but not H, satisfies the requirements of section 121. They are eligible to exclude up to $250,000 of the gain from the sale of the residence because that is the sum of each spouse's dollar limitation amount determined on a separate basis as if they had not been married ($0 for H, $250,000 for W).

Example 4. Married taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. On September 21, 2001, W sells the residence and realizes a gain of $350,000. Pursuant to section 6013(a)(3), W and H's executor make a joint return for 2001. All $350,000 of the gain from the sale of the residence may be excluded.

Example 5. Married taxpayers H and W have owned and used their principal residence since 1998. On February 16, 2001, H dies. W sells the residence on March 30, 2002. Because W's filing

status for the taxable year of the sale is single, the special rules for joint returns under paragraph (b) of this section do not apply and W may exclude only $250,000 of the gain.

(c) *Application of section 121 to only 1 sale or exchange every 2 years*—(1) *In general*. Except as otherwise provided in §1.121–3 (relating to the reduced exclusion), a taxpayer may not exclude from gross income gain from the sale or exchange of a principal residence if, during the 2-year period ending on the date of the sale or exchange, the taxpayer sold or exchanged other property for which gain was excluded under section 121. For purposes of this paragraph (c)(1), any sale or exchange before May 7, 1997 is disregarded.

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

Example. Taxpayer A owned a townhouse that he used as his principal residence for two full years, 1998 and 1999. A then bought a house in 2000 that he owned and used as his principal residence. A sells the townhouse in 2002 and excludes gain realized on its sale under section 121. A sells the house in the next year, 2003. Section 1.121–3 (relating to the reduced exclusion) does not apply to the sale of the house. Although A meets the 2-year ownership and use requirements of section 121, A is not eligible to exclude gain from the sale of the house because A excluded gain within the last 2 years under section 121 from the sale of the townhouse.

§1.121–3 Reduced exclusion.

(a) *Reduced exclusion for taxpayers failing to meet certain requirements*: *In general*. A reduced exclusion is available for a taxpayer who sells or exchanges property used as the taxpayer's principal residence but fails to satisfy the ownership and use requirements described in §1.121–1(a) or the 2-year limitation described in §1.121–2(c). This reduced exclusion applies only if the sale or exchange is necessitated by a change in place of employment, health, or, to the extent provided in forms, instructions, or other appropriate guidance including regulations and letter rulings, unforeseen circumstances. The reduced exclusion is computed by multiplying the maximum dollar limitation of $250,000 ($500,000 for certain joint filers) by a fraction. The numerator of the fraction is the shortest of the period of time that the taxpayer owned the property as the taxpayer's principal residence during the 5-year period ending on the date of the sale or exchange; the period of time that the taxpayer used the property during the 5-year period ending on the date of the sale or exchange; or the period of time between the date of a prior sale or exchange of property for which the taxpayer excluded gain under section 121 and the date of the current sale or exchange. The numerator of the fraction may be expressed in days or months. The denominator of the fraction is 730 days or 24 months (depending on the measure of time used in the numerator).

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

Example 1. Taxpayer A purchases a house that she uses as her principal residence. Twelve months after the purchase, A sells the house due to a change in place of her employment. A has not excluded gain under section 121 on a prior sale or exchange of property within the last 2 years. A is eligible to exclude up to $125,000 of the gain from the sale of her house (12/24 x $250,000).

Example 2. (i) Taxpayer H owned a house that he used as his principal residence since 1996. On January 15, 1999, H and W marry and W begins to use H's house as her principal residence. On January 15, 2000, H sells the house due to a change in H's and W's place of employment. Neither H nor W has excluded gain under section 121 on a prior sale or exchange of property within the last 2 years.

(ii) Because H and W have not both used the house as their principal residence for at least 2 years during the 5-year period preceding its sale, the maximum dollar limitation amount that may be claimed by H and W will not be $500,000, but the sum of each spouse's limitation amount determined on a separate basis as if they had not been married. (See §1.121–2(b)(2).)

(iii) H is eligible to exclude up to $250,000 of gain because he meets the requirements of section 121. W is not eligible to exclude the maximum dollar limitation amount. Instead, W is eligible to claim a reduced exclusion. Because the sale of the house is due to a change in place of employment, W is eligible to exclude up to $125,000 of the gain (365/730 x $250,000). Therefore, H and W are eligible to exclude up to $375,000 of gain ($250,000 + $125,000) from the sale of the house.

§1.121–4 Special rules.

(a) *Property of deceased spouse*—(1) *In general*. For purposes of satisfying the ownership and use requirements of section 121, a taxpayer is treated as owning and using property as the taxpayer's principal residence during any period that the taxpayer's deceased spouse owned and used the property as a principal residence before death if—

(i) The taxpayer's spouse is deceased on the date of the sale or exchange of the property; and

(ii) The taxpayer has not remarried at the time of the sale or exchange of the property.

(2) *Example*. The provisions of this paragraph (a) are illustrated by the following example:

Example. Taxpayer H has owned and used a house as his principal residence since July 1, 1987. H and W marry on July 1, 1999 and from that date they use H's house as their principal residence. H dies on August 15, 2000, and W inherits the property and continues to use the property as her principal residence. W sells the property on September 1, 2000, at which time she has not remarried. Although W has owned and used the house for less than 2 years, W will be considered to have satisfied the ownership and use requirements of section 121 because W's period of ownership and use includes the period that H owned and used the property before death.

(b) *Property owned by spouse or former spouse*—(1) *Property transferred to individual from spouse or former spouse*. If a taxpayer obtains property from a spouse or former spouse in a transaction described in section 1041(a), the period that the taxpayer owns the property will include the period that the spouse or former spouse owned the property.

(2) *Property used by spouse or former spouse*. A taxpayer is treated as using property as the taxpayer's principal residence for any period that the taxpayer has an ownership interest in the property and the taxpayer's spouse or former spouse is granted use of the property under a divorce or separation instrument (as defined in section 71(b)(2)), provided that the spouse or former spouse uses the property as a principal residence.

(c) *Tenant-stockholder in cooperative housing corporation*. A taxpayer who holds stock as a tenant-stockholder in a cooperative housing corporation (as those terms are defined in section 216(b)(1) and (2)) may be eligible to exclude gain under section 121 on the sale or exchange of the stock. In determining whether the taxpayer meets the requirements of section 121, the ownership requirements are applied to the holding of the stock and the use requirements are applied to the house or apartment that the taxpayer was entitled to occupy by reason of the taxpayer's stock ownership.

(d) *Involuntary conversions*—(1) *In general*. For purposes of section 121, the destruction, theft, seizure, requisition, or condemnation of property is treated as a sale of the property.

(2) *Application of section 1033*. In applying section 1033 (relating to involuntary conversions), the amount realized from the sale or exchange of property used as the taxpayer's principal residence

is treated as being the amount determined without regard to section 121, reduced by the amount of gain excluded from the taxpayer's gross income under section 121.

(3) *Property acquired after involuntary conversion.* If the basis of the property acquired as a result of an involuntary conversion is determined (in whole or in part) under section 1033(b) (relating to the basis of property acquired through involuntary conversion), then for purposes of satisfying the requirements of section 121, the taxpayer will be treated as owning and using the acquired property as the taxpayer's principal residence during any period of time that the taxpayer owned and used the converted property as the taxpayer's principal residence.

(4) *Example.* The provisions of this paragraph (d) are illustrated by the following example:

Example. (i) On February 18, 1999, fire destroys Taxpayer A's house that had an adjusted basis of $80,000. A had owned and used this property as her principal residence for 20 years prior to its destruction. A's insurance company paid A $400,000 for the house. Thus, A realized a gain of $320,000 ($400,000 - $80,000). On August 27, 1999, A purchases a new house at a cost of $100,000.

(ii) Because the destruction of the house is treated as a sale for purposes of section 121, A will exclude $250,000 of the realized gain from A's gross income. For purposes of section 1033, the amount realized is then treated as being $150,000 ($400,000 - $250,000) and the gain realized is $70,000 ($150,000 amount realized - $80,000 basis). A elects under section 1033 to recognize only $50,000 of the gain ($150,000 amount realized - $100,000 cost of new house). The remaining $20,000 of gain is deferred and A's basis in the new house is $80,000 ($100,000 cost - $20,000 gain not recognized).

(iii) A will be treated as owning and using the new house as A's principal residence during the 20-year period that A owned and used the destroyed house.

(e) *Determination of use during periods of out-of-residence care.* If a taxpayer has become physically or mentally incapable of self-care and the taxpayer sells or exchanges property that the taxpayer owned and used as the taxpayer's principal residence for a period aggregating at least 1 year during the 5-year period preceding the sale or exchange, the taxpayer is treated as using the property as the taxpayer's principal residence for any period of time during the 5-year period in which the taxpayer owns the property and resides in any facility (including a nursing home) licensed by a State or political subdivision to care for an individual in the taxpayer's condition.

(f) *Sales of remainder interests*—(1) *In general.* A taxpayer may elect to have the section 121 exclusion apply to gain from the sale or exchange of a remainder interest in the taxpayer's principal residence.

(2) *Limitations*—(i) *Sale or exchange of any other interest.* If a taxpayer elects to exclude gain from the sale or exchange of a remainder interest in the taxpayer's principal residence, the section 121 exclusion will not apply to a sale or exchange of any other interest in the residence that is sold or exchanged separately.

(ii) *Sales to related parties.* Paragraph (f)(1) of this section will not apply to a sale or exchange by any person who bears a relationship to the taxpayer which is described in section 267(b) or 707(b).

(3) *Election.* The taxpayer makes the election under this paragraph (f) by filing a return for the taxable year of the sale or exchange that does not include the gain from the sale or exchange of the remainder interest in the taxpayer's gross income.

(g) *No exclusion for expatriates.* The section 121 exclusion will not apply to any sale or exchange by an individual if the treatment provided by section 877(a)(1) (relating to the treatment of expatriates) applies to the individual.

(h) *Election to have section not apply.* A taxpayer may elect to have the section 121 exclusion not apply to a sale or exchange of property. The taxpayer makes the election by filing a return for the taxable year of the sale or exchange that includes the gain from the sale or exchange of the taxpayer's principal residence in the taxpayer's gross income.

(i) *Residences acquired in rollovers under section 1034.* If a taxpayer acquires property (section 121 property) in a transaction that qualifies under section 1034 for the nonrecognition of gain realized on the sale or exchange of another property (section 1034 property) and later sells or exchanges the section 121 property, in determining the period of the taxpayer's ownership and use of the sold or exchanged section 121 property, the taxpayer may include the periods that the taxpayer owned and used the section 1034 property as the taxpayer's principal residence (and each prior residence taken into account under section 1223(7) in determining the holding period of the 1034 property).

§1.121–5 [Removed]

Par. 3. Section 1.121–5 is removed.

Par. 4. Section 1.1398–3 is added to read as follows:

§1.1398–3 Treatment of section 121 exclusion in individuals' title 11 cases.

(a) *Scope.* This section applies to cases under chapter 7 or chapter 11 of title 11 of the United States Code, but only if the debtor is an individual.

(b) *Definition and rules of general application.* For purposes of this section, section 121 exclusion means the exclusion of gain from the sale or exchange of a debtor's principal residence available under section 121.

(c) *Estate succeeds to exclusion upon commencement of case.* The bankruptcy estate succeeds to and takes into account the section 121 exclusion with respect to the property transferred into the estate.

(d) *Effective date.* This section is applicable for sales or exchanges that occur on or after the date these regulations are published as final regulations in the **Federal Register.**

Robert E. Wenzel,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 6, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 10, 2000, 65 F.R. 60136)

Notice of Proposed Rulemaking and Notice of Public Hearing

Classification of Certain Pension and Employee Benefit Trusts, and Other Trusts

REG–108553–00

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed amendments to the regulations defining a domestic or foreign trust for federal tax purposes. The proposed regu-

lations will affect certain specified employee benefit trusts and investment trusts. The proposed amendments provide that these employee benefit trusts and investment trusts are deemed to satisfy the control test for domestic trust treatment if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by January 10, 2001. Requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for January 31, 2001, at 10 a.m. must be submitted by January 10, 2001.

ADDRESSES: Send submissions to: CC:M&SP:RU (REG–108553–00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:M&SP:RU (REG–108553–00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/tax_regs/regslist.html. The public hearing will be held in the Internal Revenue Service Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, James A. Quinn, (202) 622-3060; concerning submissions and the hearing, Guy R. Traynor, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Section 401(a) requires a trust forming part of a pension, profit-sharing, or stock bonus plan (qualified plan trust) to be created or organized in the United States in order to be a qualified trust. Similarly, section 408(a) requires an individual retirement account trust (IRA trust), which also includes a trust for a Simple IRA described in section 408(p) and a trust for a Roth IRA described in section 408A, to be created or organized in the United States. Section 1.401–1(a)(3)(i) further provides that a trust will not constitute a qualified trust under section 401(a) unless the trust is maintained at all times as a domestic trust in the United States. Under §1.408–2(b), a similar requirement applies to an IRA trust.

Prior to the enactment of the Small Business Job Protection Act (SBJPA), Public Law 104–188 (110 Stat. 1755) (August 20, 1996), the status of a qualified plan trust as a domestic trust generally turned on a facts and circumstances determination that the trust was a resident trust and was subject to the continuous jurisdiction of the United States. See, for example, Rev. Rul. 70–242 (1970–1 C.B. 89) regarding the determination of domestic trust status for purposes of section 401(a).

The SBJPA and the Taxpayer Relief Act of 1997 (TRA 97), Public Law 105–34 (111 Stat. 788) (August 5, 1997), amended section 7701(a)(30) to provide objective criteria for determining whether a trust is a domestic trust. New section 7701(a)(30)(E) provides that a trust will be treated as a domestic trust if: (1) a court within the United States is able to exercise primary supervision over the administration of the trust (court test), and (2) one or more United States persons have the authority to control all substantial decisions of the trust (control test). These changes are generally effective for taxable years beginning after December 31, 1996.

Section 301.7701–7, published in the **Federal Register** on February 2, 1999 (64 FR 4967), provides guidance under section 7701(a)(30)(E) in determining whether a trust is treated as a United States person and therefore as a domestic trust for federal tax purposes. The regulations are generally effective for taxable years ending after February 2, 1999, but may be applied by taxpayers for taxable years beginning after December 31, 1996. In addition, section 1907(a)(3) of the SBJPA, as amended by the TRA 97, generally provides that, to the extent prescribed in regulations, a trust that was in existence on August 20, 1996, and that was treated as a United States person on August 19, 1996, may elect to continue to be treated as a United States person. Section 301.7701–7(f) provides rules governing this election to continue to be treated as a United States person.

Section 301.7701–7(d) provides guidance on the application of the control test, including defining United States persons, substantial decisions, and control. Generally, for purposes of the control test, all persons with any power over substantial decisions of the trust, whether acting in a fiduciary capacity or not, must be counted for purposes of the control test.

However, §301.7701–7(d)(1)(iv) provides a special rule for certain employee benefit trusts listed therein. These trusts are required to be created or organized in the United States and are subject to other detailed requirements for qualification under the Internal Revenue Code (Code). Therefore, §301.7701–7(d)(1)(iv) provides that these trusts are deemed to satisfy the control test, provided that United States fiduciaries control all of the substantial decisions of the trust that are made by the trustees or fiduciaries. Section 301.7701–7(d)(1)(iv) authorizes the Commissioner to designate additional categories of trusts subject to the special rule in revenue procedures, notices, or other guidance published in the Internal Revenue Bulletin.

Explanation

The IRS and the Treasury Department have become aware of two additional categories of trusts that should qualify for the special control test rule in §301.7701–7(d)(1)(iv).

The first category is group trusts consisting of qualified plan trusts and IRA trusts, as described in Rev. Rul. 81–100 (1981–1 C.B. 326). If the requirements set forth in Rev. Rul. 81–100 are met, a group trust is itself exempt from tax, and the tax-exempt status of the participating trusts is not affected by the pooling of their funds in the group trust. One of the requirements is that the group trust must be created or organized in the United States and must be maintained at all times as a domestic trust in the United States. Because these trusts are required to be created or organized in the United States and are subject to other detailed requirements, they are similar to the other categories of employee benefit trusts listed in §301.7701–7(d)(1)(iv). Therefore, the proposed regulations add group trusts de-

scribed in Rev. Rul. 81–100 to the categories of trusts that may use the special control test rule.

The second category is certain investment trusts that are classified as trusts under §301.7701–4(c)(1). An investment trust with a single class of ownership interests, representing undivided beneficial interests in the assets in the trust, is classified as a trust if there is no power under the trust agreement to vary the investment of the certificate holders. In addition, an investment trust with multiple classes of ownership interests, in which there is no power under the trust agreement to vary the investment of the certificate holders, is classified as a trust if the trust is formed to facilitate direct investment in the assets of the trust and the existence of multiple classes of ownership interests is incidental to that purpose. These trusts are treated as owned by the investors under the grantor trust rules of subpart E, part I, subchapter J, chapter 1 of the Code.

The proposed regulations add investment trusts classified as trusts under §301.7701–4(c)(1) to the categories of trusts that may use the special control test rule, provided the investment trusts meet the conditions described in §301.7701–7(d)(1)(iv)(I). These trusts are subject to reporting requirements as domestic grantor trusts, and each investor must report the items of income, deduction, and credit that are attributable to the investor's portion of the trust. The conditions set forth in the proposed regulations are intended to ensure that all trustees are United States persons including at least one institutional United States trustee, the sponsors (persons who exchange investment assets for beneficial interests with a view to selling the beneficial interests) are United States persons, and the beneficial interests are widely offered for sale primarily in the United States to United States persons. An investment trust that satisfies these conditions is deemed to satisfy the control test even though one or more investors may be foreign persons with the power to make a substantial decision of the trust.

In addition, the IRS and the Treasury Department have become aware of concerns expressed by taxpayers in applying the special rule of §301.7701–7(d)(1)(iv) with respect to determining whether a person is or is not a fiduciary for purposes of the control test. For example, under section 3(14)(A) of the Employee Retirement Income Security Act of 1974 (ERISA), Public Law 93–406 (88 Stat. 829) (September 2, 1974), a variety of persons in addition to the trustee(s) is considered fiduciaries with respect to an employee benefit trust. In contrast, under ordinary trust principles the fiduciary of a trust is generally considered to be the trustee holding legal title to the trust assets on behalf of those having a beneficial interest therein. Section 301.7701–6(b). Therefore, these regulations propose to amend §301.7701–7(d)(1)(iv) relating to the application of the control test of section 7701(a)(30)(E) to clarify that employee benefit trusts and certain investment trusts identified in the regulations are deemed to satisfy the control test if United States trustees control all of the substantial decisions of the trust made by the trustees of the trust.

Taxpayers concerned with maintaining domestic trust status should also note that, in appropriate cases, it may still be possible to elect pursuant to §301.7701–7(f) to treat a trust existing on August 19, 1996, as a United States person.

Application to Certain Pension Trusts Created or Organized in Puerto Rico

Section 1022(i)(1) of ERISA provides for tax exemption for certain trusts created or organized in Puerto Rico that form part of a pension, profit-sharing, or stock bonus plan. Section 1022(i)(2) and §1.401(a)–50 generally provide that the administrator of such a trust may elect to have the trust treated as a trust created or organized in the United States for purposes of section 401(a). In light of the changes made to section 7701(a)(30) in the SBJPA and the TRA 97, and the ensuing regulations, some taxpayers have expressed concerns regarding the continuing application of sections 1022(i)(1) and (2) and §1.401–50 to a pension trust created or organized in Puerto Rico that is not a domestic trust within the meaning of section 7701(a)(30). Because the application of these provisions is not restricted to trusts that are domestic trusts within the meaning of section 7701(a)(30), the 1996 and 1997 amendments to section 7701(a)(30) and the ensuing regulations do not affect the application of these provisions.

Proposed Effective Date

The amendments to the regulations are proposed to be applicable to trusts for taxable years ending on or after the date on which these regulations are published as final regulations in the **Federal Register**. It is anticipated that the final regulations will provide that trusts will be able to rely on the final regulations for taxable years beginning after December 31, 1996, and for electing trusts under section 1907(a)(3)(B) of the SBJPA for taxable years ending after August 20, 1996. In addition, for taxable years beginning after December 31, 1996, and taxable years ending before these regulations are finalized, or for electing trusts under section 1907(a)(3)(B) of the SBJPA for taxable years ending after August 20, 1996, and before these regulations are finalized, the status of a trust as a qualified plan trust under section 401(a), an IRA trust under section 408(a), or any other employee benefit trust described in §301.7701–7(d)(1)(iv) of these proposed regulations will not be challenged by the IRS based on a failure of the trust to satisfy the control test of section 7701(a)(30)(E)(ii) and, therefore, a failure to be maintained at all times as a domestic trust in the United States, if the trust satisfies the control test safe harbor set forth in §301.7701–7(d)(1)(iv) of these proposed regulations or §301.7701–7(d)(1)(iv) of the final regulations published in the **Federal Register** on February 2, 1999.

Special Analyses

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

the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing.

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for January 31, 2001, at 10 a.m. in the Internal Revenue Service Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

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

Persons that wish to present oral comments at the hearing must submit written comments by January 10, 2001, and submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by January 10, 2001.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

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

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Proposed Amendments to the Regulations

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

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.7701–7 is amended as follows:

1. Paragraph (d)(1)(iv) introductory text is revised.

2. Paragraph (d)(1)(iv)(H) is redesignated as paragraph (d)(1)(iv)(J).

3. New paragraphs (d)(1)(iv)(H) and (I) are added.

4. Paragraph (d)(1)(v) *Example 1* is revised and *Example 5* is added.

5. The first sentence of paragraph (e)(1) is revised.

6. Paragraph (e)(3) is added.

The revisions and additions read as follows:

§301.7701–7 Trusts—domestic and foreign.

* * * * *

(d) * * * (1) * * *

(iv) *Safe harbor for certain employee benefit trusts and investment trusts*. Notwithstanding the provisions of this paragraph (d), the trusts listed in this paragraph (d)(1)(iv) are deemed to satisfy the control test set forth in paragraph (a)(1)(ii) of this section, provided that United States trustees control all of the substantial decisions made by the trustees of the trust—

* * * * *

(H) A group trust described in Rev. Rul. 81–100 (1981–1 C.B. 326) (See §601.601(d)(2) of this chapter);

(I) An investment trust classified as a trust under §301.7701–4(c), provided that the following conditions are satisfied—

(*1*) All trustees are United States persons and at least one of the trustees is a bank, as defined in section 581, or a United States Government-owned agency or United States Government-sponsored enterprise;

(*2*) All sponsors (persons who exchange investment assets for beneficial interests with a view to selling the beneficial interests) are United States persons; and

(*3*) The beneficial interests are widely offered for sale primarily in the United States to United States persons;

* * * * *

(v) * * *

Example 1. Trust is a testamentary trust with three fiduciaries, *A*, *B*, and *C*. *A* and *B* are United States citizens and *C* is a nonresident alien. No persons except the fiduciaries have authority to make any decisions of the trust. The trust instrument provides that no substantial decisions of the trust can be made unless there is unanimity among the fiduciaries. The control test is not satisfied because United States persons do not control all the substantial decisions of the trust. No substantial decisions can be made without *C*'s agreement.

* * * * *

Example 5. *X*, a foreign corporation, conducts business in the United States through various branch operations. *X* has United States employees and has established a trust as part of a qualified employee benefit plan under section 401(a) for these employees. The trust is established under the laws of State *A*, and the trustee of the trust is *B*, a United States bank governed by the laws of State *A*. *B* holds legal title to the trust assets for the benefit of the trust beneficiaries. A plan committee makes decisions with respect to the plan and the trust. The plan committee can direct *B*'s actions with regard to those decisions and under the governing documents *B* is not liable for those decisions. Members of the plan committee consist of United States persons and nonresident aliens, but nonresident aliens make up a majority of the plan committee. Decisions of the plan committee are made by majority vote. In addition, *X* retains the power to terminate the trust and to replace the United States trustee or to appoint additional trustees. This trust is deemed to satisfy the control test under paragraph (d)(1)(iv) of this section because *B*, a United States person, is the trust's only trustee. Any powers held by the plan committee or *X* are not considered under the safe harbor of paragraph (d)(1)(iv) of this section. In the event that *X* appoints additional trustees including foreign trustees, any powers held by such trustees must be considered in determining whether United States trustees control all substantial decisions made by the trustees of the trust.

* * * * *

(e) *Effective date*—(1) *General rule*. Except for the election to remain a domestic trust provided in paragraph (f) of this section and except as provided in paragraph (e)(3) of this section, this section is applicable to taxable years ending after February 2, 1999.

* * * * *

(3) *Effective date of safe harbor for certain employee benefit trusts and investment trusts*. Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section apply to trusts for taxable years ending on or after the date of publication of final regulations in the **Federal Register**. Paragraphs (d)(1)(iv) and (v) *Examples 1* and *5* of this section may be relied on by trusts for taxable years beginning after December 31, 1996, and also may be relied on by

trusts whose trustees have elected to apply sections 7701(a)(30) and (31) to the trusts for taxable years ending after August 20, 1996, under section 1907(a)(3)(B) of the SBJP Act.

* * * * *

David A. Mader,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on October 10, 2000, 3:31 p.m., and published in the issue of the Federal Register for October 12, 2000, 65 F.R. 60821)

Amendment of Qualified Plans for Final Regulations Under § 411(d)(6)

Announcement 2000–71

Final regulations under § 411(d)(6) of the Code were published in the Federal Register on September 6, 2000. The regulations grant relief under § 411(d)(6) by permitting qualified defined contribution plans to be amended, under certain conditions, to eliminate some alternative forms of payment and to eliminate or limit the right to receive certain in-kind distributions. The final regulations also permit certain transfers between plans that were not previously permitted. The regulations generally apply to amendments adopted, and transfers made, on or after September 6, 2000.

Effective September 6, 2000, plan sponsors may adopt plan amendments that are permitted under the final regulations under § 411(d)(6). Determination letters that are issued with respect to plans for which an application is filed with the Service on or after September 6, 2000, may be relied upon with respect to whether a plan satisfies the requirements of the final regulations.

Some plans might contain language that would necessitate a change to conform to the final regulations (as described below). Such a plan must be amended, in connection with its application for a determination letter, to satisfy the final regulations. See below regarding the effective date of the amendment.

Plan sponsors that have determination letter applications on file with the Service which were submitted before September 6, 2000, should contact the Service if they wish to amend their plans and have the provisions of the final regulations taken into account in their determination letters. Plan sponsors should contact the EP specialist who has been assigned to review their application, if possible. Otherwise, they should contact Customer Service at 1-877-829-5500. In these cases, the Service will try to accommodate the plan sponsor's request to have the provisions of the final regulations taken into account in the determination letter. However, if the EP specialist assigned to review the application has already completed that review, the Service will not be able to accommodate the plan sponsor's request and a new application and user fee will be required.

In general, the final regulations expand the permitted changes that may be made to alternative forms of payment and in-kind distributions under a defined contribution plan and, in the case of voluntary direct transfers between plans, the circumstances under which elimination of optional forms of benefit is permitted. Generally, therefore, plan sponsors may choose to amend their plans as a result of these changes, but are not required to do so, except as provided below.

The regulations under § 411(d)(6), as in effect prior to September 6, 2000, ("the 1988 regulations") permitted elimination of optional forms of benefit in connection with voluntary direct transfers between plans, provided certain requirements were satisfied. Section 401(a)(31), which was added after the 1988 regulations, requires that participants be able to elect a direct rollover to an IRA or other eligible retirement plan of any eligible rollover distribution. Because the requirements of § 411(d)(6) do not apply to amounts distributed, including those amounts directly rolled over under § 401(a)(31), the voluntary direct transfer rules in the 1988 regulations produce the same § 411(d)(6) result with respect to an eligible rollover distribution as a direct rollover under § 401(a)(31).

The final regulations under § 411(d)(6) generally eliminate this duplication. The final regulations provide, in part, that relief from the requirements of § 411(d)(6) is not available under the voluntary transfer rules where the participant is entitled to elect a § 401(a)(31) direct rollover because the participant is eligible to receive an immediate distribution of the participant's entire nonforfeitable accrued benefit in a single-sum distribution that would consist entirely of an eligible rollover distribution within the meaning of § 401(a)(31)(C). This provision of the final regulations is effective for transfers occurring on or after January 1, 2002.

Some plans might contain pre-existing provisions that permit elimination of optional forms of benefit pursuant to the voluntary direct transfer rules as in effect under the 1988 regulations. To the extent that these plan provisions are inconsistent with the final regulations under § 411(d)(6), as described in the preceding paragraph, the plan must be amended. The amended plan must provide that the benefit of a participant described in the preceding paragraph may be voluntarily transferred only through a § 401(a)(31) direct rollover.

Any plan amendment required to conform the plan terms to the final § 411(d)(6) regulations does not have to be adopted prior to the end of the plan's GUST remedial amendment period, as described in Rev. Proc. 2000–27, 2000–26 I.R.B. 1272, and Rev. Proc. 2000–20, 2000–6 I.R.B. 553. However, as provided above, if a determination letter application for the plan is filed on or after September 6, 2000, the required plan amendment must be adopted in connection with the application. In any case, the plan amendment must be effective no later than January 1, 2002.

Changes to Codes for IRAs on the 2001 Form 1099–R

Announcement 2000–86

Purpose: The purpose of this announcement is to advise payers making distributions from IRAs of changes to the distribution codes entered in box 7 on the 2001 Form 1099–R, *Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc.*

Changes to Distribution Codes

1. Notice 2000–30, 2000–25 I.R.B. 1266, specifies a new method for reporting recharacterizations and reconversions occurring after 2000.
Result. Because of Notice 2000–30, the following changes are being made to the distribution codes:

- **Code N** is added for reporting a "Recharacterized IRA contribution made for 2001."
- **Code R** is changed to report a "Recharacterized IRA contribution made for 2000."

2. Only two distribution codes can be entered in box 7 on Form 1099-R. Therefore, payers were only able to report a distribution as the result of an excess contribution to a Roth IRA by using Code J with Code 8 or P. Payers could not use Code 1, 2, 3, or 4 if Codes J and 8 or P applied.
Result. To alleviate this reporting problem, the following changes are being made to the distribution codes:

- **Code J** is changed to report an "Early distribution from a Roth IRA, no known exception."
- **Code T** is added to report a "Roth IRA distribution, exception applies."

Therefore, payers can only use the following codes for a Roth IRA distribution:

- Code J for an early distribution from a Roth IRA, no known exception. (Do not use Code 1 with Code J. However, you must use Code 5, 8, or P, if applicable.)
- Code T for a distribution from a Roth IRA, exception applies. (Do not use Code 2, 3, 4, or 7 with Code T. However, you must use Code 5, 8, or P, if applicable.)

Foundations Status of Certain Organizations

Announcement 2000–87

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

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

Acorn International, Inc., Waterbury, VT
Actex Foundation, Inc., Winsted, CT
Adventure Education of Vermont, Burlington, VT
Ahepa 250-III, Inc., Groton, CT
Alliance for the Commonwealth, Inc., Boston, MA
American Bilingual Community Association, Inc., Richmond Hill, NY
American Dream Houses Association, Inc., Baltimore, MD
American Safe Boating Foundation, Inc., Mentor, OH
Apollonian Society, Chicago, IL
Arts in Motion, Conway, NH
Artspans, Dunbarton, NH
Association for the Advancement of Psychosynthesis, St. Louis, MO
Attleboro Friends of Cats, Inc., Attleboro, MA
Balamand Educational Foundation, Inc., Winchester, MA
Balkan Studies Institute, Inc., Newton, MA
Baystate Affordable Housing Agency, Inc., Somerville, MA
Bennington Foster Parent Association, Bennington, VT
Berkley Athletic Association, Inc., Berkley, MA
Biblical Counseling Center, Farmington, NM
100 Black Men of Bridgeport, Inc., Bridgeport, CT
Blackfriars School of Fence, Inc., Paso Robles, CA
Boston Public Sailing, Inc., Winthrop, MA
Boston Urological Society, Inc., Boston, MA
Brattleboro Area Affordable Housing Corporation, Brattleboro, VT
Briar Crest I Affordable Housing Corp., St. Joseph, MI
Brockton Hispanic Community Center, Brockton, MA
Brownsville Housing Opportunity Corporation, Brownsville, TX
Brunswick Bambino Baseball League, Brunswick, ME
Bryan Elementary PTO, Bryan, OH
Bucket Full of Friends, Inc., Clinton, CT
Build the Monument Foundation, Inc., Bedford, NH
Camping and City Children, Inc., Lynn, MA
Care Works, Inc., Medford, MA
Caroline County Community Action Agency, Inc., Bowling Green, VA

Carosello Musicale Italiano, Inc., Hartford, CT
Center for Security and Social Progress, Inc., Waban, MA
Central City Economic Development Corporation, Inc., Los Angeles, CA
Central Vermont Memorial Civic Center, Inc., Montpelier, VT
Central Vermont Supervised Visitation Center, Montpelier, VT
Centre for Successful Aging Foundation, Inc., Stamford, CT
Chamblee Foundation, Ltd., Glendale, CA
Charis Institute, Inc., Danvers, MA
Charity Foundation, Inc., Boston, MA
Charlotte Land Trust, Inc., Charlotte, VT
Child Charitable Development Association, New Canaan, CT
Children of the Middle Passage, Inc., New York, NY
Children of Today International Youth Center, Detroit, MI
Childrens Annex Ellenville Child Care Center, Inc., Ellenville, NY
Childrens Lighthouse, Inc., Charlestown, MA
Childrens Television Consortium, Inc., Hyannis, MA
Chinese Culture Development and Promotion Council, Inc., Quincy, MA
Christian Stewardship Fund, Inc., Boston, MA
Christians Building Urban Communities, Inc., Chicago, IL
Cindi Foundation, Coventry, RI
Civil War Roundtable of the Merrimack, Inc., Newburyport, MA
Coachella Valley Society for the Prevention of Cruelty to Animals, Palm Desert, CA
Columbus County Dream Cntr., Inc., Whiteville, NC
Comite Pro Festival Latino-Americano De Queens, Jackson Heights, NY
Community Collaborative of Bridgeport, Inc., Bridgeport, CT
Community Eyecare Services, Ltd., Charlottesville, VA
Community Improvement Program, Inc., Roxbury, MA
Community Mobilization Team, Inc., Portland, ME
Community Organized Prevention Effort (COPE), Deerfield, NH
Companion Resource Corp., Buffalo, NY
Compost Charitable Corporation, Jamaica Plain, MA
Concerned Child Care Providers, New Bedford, MA
Concerned Maine Families Foundation, Portland, ME
Creative Gifts, Inc., Hartford, CT
Cultural Resources, Inc., Blue Hill, ME
Dare to Dream Educational Farm Program, Inc., Orange, MA
Desfile Puertorriqueno, Trenton, NJ
Disabled Individuals for Recreational Activities (DIRA), S. Dartmouth, MA
Dive 4 Life, Inc., Chicago, IL
Elm Terrace Development Corporation, New Haven, CT
Emanuel Baptist Church Jamaica Square Alliance, Elmont, NY
Environmental Council of Alabama, Inc., Highland Home, AL
Faces Foundation for World Peace, Inc., Ridgefield, CT
Families and Friends of People with Special Needs, Inc., Bronx, NY
Family Day Care Association of Suffolk County, Inc., W. Babylon, NY
Fathers of Imani, Inc., Milwaukee, WI
Festival Italiano, Inc., New London, CT
Florida Stars for Children, Inc., St. Petersburg, FL
Fontana Academy of Martial Arts, Fontana, CA
Foundation for the Seventh Fire, Groton, MA
Foundation of Youth, Luray, VA
Francophone Broadcasting Corporation, Woburn, MA
Friends of Atlantic Theatre Festival Society, Ltd., Cohasset, MA
Friends of BHS Girls Ice Hockey, Inc., Boston, MA
Friends of CAP, Cranston, RI
Friends of North Star Academy Charter School, Inc., Springfield, MA
Friends of the Capen-Reynolds Farm, Inc., Stoughton, MA
Friends of the Holmes School Mural, Inc., Westport, CT
Friends of the Mashpee National Wildlife Refuge, Inc., Mashpee, MA
Friends of the Union for Infants Protection in Lebanon, Rego Park, NY
Friends of the West River Trail, Jamaica, VT
Friends of the Wolfeboro Community Bandstand, Inc., Wolfeboro, NH
Friends of the Yankee Brass, Inc., White River Jct, VT
Gamma ETA Educational Foundation, Inc., Tallahasee, FL
Gateway Babe Ruth League, Inc., Wareham, MA
Geauga County Mounted Unit, Inc., Novelty, OH
GLO of Hartford, Inc., Hartford, CT
Global Commission to Fund the United Nations, St. Augustine, FL
Gloucester Fishermans Wives Development Programs, Inc., Gloucester, MA
Goshen Soccer Club, Inc., Torrington, CT
Greater New York Association of Holocoust, Woodsburgh, NY
Green Olive Tree, Inc., Crozet, VA
Greenforest Community Development, Incorporated, Decatur, GA
Dr. Grover C. Hunter University of North Carolina Dental Trust Fund, Atlanta, GA
H3, Inc., Cambridge, MA
Happy Prayer House, Tehachapi, CA
Harrington School Foundation, American Fork, UT
Haven, Inc., Braintree, MA
He is the Bright and Morning Star Ministries, Milwaukee, WI
Heartstone Alzheimers Foundation, Inc., Wellesley, MA
Henry & Yorelis Alvarez Ministries, Inc., Weslaco, TX
Heritage Preservation Committee of Monroe, Inc., Monroe, NY
Hispanic Association for Bilingual Literacy and Education of Conn., Inc., Southington, CT
Hockey for Caribou, Caribou, ME
Hodges Village Environmental Education Association, Oxford, MA
Holyoke Power, Inc., Holyoke, MA
Hope Ministries, Inc., Medford, MA
Houses to Homes, Inc., Somerville, MA
Hudson Highlands Music Festival, Inc., Garrison, NY
Institute for Fundamental Sciences, Irvine, CA
Interfaith Council for Elders, Inc., Needham, MA
Interfaith Volunteer Caregivers of Greater Bridgeport, Inc., Bridgeport, CT
Israel Center for International Environmental Studies-US, Inc., Needham, MA
Itasca Rotary Student Partnership, Grand Rapids, MN
Jamaica Plain Youth Soccer, Inc., Jamaica Plain, MA

Jeffrey P. Nelen Memorial Golf Tournament, Inc., Springfield, MA
Jessi's Gift, Biddeford, ME
Just Do It Youth Services, Oakland, CA
Karnei Shomrom Foundation, Inc., New York, NY
Knox Booster Club, Knox, ME
Laborers in the Harvest, Inc., Magnolia, AR
Las Manos Foundation, Healdsburg, CA
Ledyard Girls Softball League, Ledyard, CT
Life Enhancement Seminars, Inc., Wynnwood, PA
Lincoln Little League, Inc., Lincoln, RI
Linda McDonald Ministries, Castle Rock, CO
Lords Manna, Los Angeles, CA
Loring Memorial Park Development Association, Inc., Portland, ME
Lubbock Therapeutic Center, Inc., Lubbock, TX
Lunenburg Hockey Association, Lunenburg, MA
Lyceum Educational Corporation, Milford, CT
Manderlee Productions, Inc., Rocky Hill, CT
Mariana Braceti and Rincon De Gautier Institute, Inc., Springfield, MA
Marion Road Athletic Association, Macon, GA
Matthew Twenty-Five Foundation, Inc., Arlington, TX
Melrose East New Directions, Inc., Baton Rouge, LA
Meriden Arts Council, Inc., Meriden, CT
Metro IAF, Inc., Rego Park, NY
Micah Foundation, Highland Park, IL
Middlesex Law Libraries Foundation, Inc., Cambridge, MA
Milford Pop Warner Association, Inc., Milford, MA
Minority Business Association, Inc., Burlington, VT
Mission Impossible, Spanaway, WA
Missisquoi Health Center, Swanton, VT
Montesano Football Parents Club, Montesano, WA
Move Over Broadway Productions, Inc., Canfield, OH
National Affordable Housing Foundation Charlotte II, Inc., Boston, MA
National Housing & Development Non-Profit Corporation, Hartford, CT
NCOBPS, Inc., North Oaks, MN
New England Corporate Aids Consortium, Inc., Lexington, MA
New Hampshire Harm Reduction Alliance, Manchester, NH
New Traveller Fund, Santa Monica, CA
New York Presbytery of the Korean Presbyterian Church in America, Staten Island, NY
North Andover 350th Anniversary, North Andover, MA
North Coast Express Academy of Basketball, Alameda, CA
North Country Thresholds & Decisions NCTD, Enfield, NH
North Suffolk Foundation, Inc., Smithtown, NY
Northern New England Transplant Alliance, Portland, ME
Norwich Communications and Technology Learning Center, Inc., Norwich, CT
Optimist International Chester South Chester Pennsylvania Club, Chester, PA
Orange County Pro Bono Legal Services, Inc. Goshen, NY
Orford Village Housing Development Corporation, Manchester, CT
Organization for the Poor People in Haiti, Inc., S. Ozone Pk, NY
Otter Creek Research Corporation, Springport, MI
Otter Valley Football Club, Ltd., Brandon, VT
Owen L. Wells Foundation, Inc., Boston, MA
Ozark Harvest, Inc., Gravette, AR
Mike Pagliarulo Foundation, Inc., Winchester, MA
Pentucket Regional School District Parent Alliance, Inc., W. Newbury, MA
People Helping People, Inc., Newport, VT
People Promoting Progress, Inc., Los Angeles, CA
Phase I Recovery House, Inc., Brattleboro, VT
Philadelphia Center for Organizational Dynamics, Melrose Park, PA
Photography Preservation Society, St. Louis, MO
Pinardville Booster Club, Goffstown, NH
PLAY, Inc., Lincoln, RI
Pomfret Emergency Services Corporation, N. Pomfret, VT
Pregnancy Help Center of Wayne County, Goldsboro, NC
Prison Families of New York, Inc., Albany, NY
Project Play, Inc., North Haven, CT
Provincetown Repertory Theatre, Inc., Provincetown, MA
Public Utility Policy Institute, Concord, NH
Quincy Transportation, Inc., Quincy, MA
Raylynmor Opera, Peterborough, NH
Red Ribbon Foundation, Inc., Greenwich, CT
Revived Theatre Inc., Those People Who Put on Plays, Seekonk, MA
Rhode Island Committee for Non-Violence Initiatives, Inc., Providence, RI
Rhode Island Council of Family Mediators, Warwick, RI
Rising Stars Therapeutic Riding, Inc., W. Hartford, CT
Riverside Academy, Ltd., Lowell, MA
Rosh Hodesh Exchange, Somerville, MA
Roundtable Center, Portland, ME
Roxbury South End Tenants Association, Inc., Boston, MA
Rural Opportunity Fund, Poteau, OK
Rural School and Community Trust, Washington, DC
Sabor Foundation, San Antonio, TX
Sabrinnas Angels, Carmel, NY
Scandanavian Collectors Club, Rockville, MD
Schoolworks Foundation, Inc., Westport, CT
Seeds of Change Education Fund, Inc., Somerville, MA
Sellecca-Tesh Foundation for the Forgotten Generation, Los Angeles, CA
SHA Development Corp, Seymour, CT
Shiloh Manor, Inc., Middletown, CT
Shots Across Texas Coalition, Austin, TX
Siloam Mission Worldwide, Los Angeles, CA
Society Affects Students, Incorportated, Middletown, RI
Southeastern Area Lacrosse, Inc., Mystic, CT
Spirit of Truth Foundation, Washington, DC
Springfied Armory National Park, Tr, Southport, CT
Staff, Inc., North Haven, CT
Stand By Me, Inc., Waterbury, CT
Steven B. Fox Foundation, Inc., Brattleboro, VT
Stinesville Renaissance Group, Stinesville, IN
Stop the Violence, Olympia, WA
Strong-Cuevas Foundation, Inc., New York, NY

Stylettes Drill Team and Drum Corp, West Haven, CT
Suffolk County Society for the Prevention of Cruelty to Animals, Huntington, NY
Team Connecticut, New Haven, CT
Technology for Learning, Inc., Providence, RI
Tender Loving Care Mercy Ministries, Detroit, MI
Theatre for Dramatic Development, New York, NY
Thoughtform Research Institute, Bountiful, UT
Transcription Technologies, Inc., Vernon, CT
Tri County Partnership, Inc., Spencer, WV
Tripod Foundation, Williamstown, MA
U.S. Peace 2000, Nashville, TN
Vera Arterburn Memorial Scholarship Fund, Inc., Glastonbury, CT
31 Verdun St., Inc., Dorchester, MA
Vermont Center Economic Environmental & Social Justice, Inc., Burlington, VT
Vermont Financial Research Institute, Burlington, VT
Vetiver Network, Bellingham, WA
Vineyard Initiative for Teaching & Alternative Education, Inc., Oak Bluffs, MA
Virtual Reality Foundation, Inc., Cambridge, MA
Virtually Wired Educational Foundation, Boston, MA
Vital Live Center for Adolescence, Lake Forest, CA
Vitas Gerulaitis Youth Foundation, New York, NY
Walk the Walk Trust, Bayside, NY
Walnut Square Tower Clock Foundation, Inc., Haverhill, MA
Wareham Babe Ruth League, Inc., Wareham, MA
Warmline of Northeastern Connecticut, Inc., Willimantic, CT
Watson Park Playground Project, Inc., E. Braintree, MA
Wedum-Presbyterian Homes Affordable Housing, Inc., Arden Hills, MN
West Point Park and Recreation Association, West Point, CA
Westside Girls Softball, Pueblo, CO
What Would Jesus Do, Inc., Citrus Heights, CA
Wheel-eez, Inc., Feeding Hills, MA
Widowed Persons Service of Greater Bridgeport, Inc., Fairfield, CT
Widowed Persons Service of Marion County, Inc., Silver Springs, FL
Willing to Help, Chicago, IL
Windhorse Publications USA, Missoula, MT
Winter Park Christian School, Inc., Fraser, CO
WIT Productions, Inc., Boston, MA
Women and Children First, Inc., Wallingford, CT
Worchester Institute of Contemporary Issues & Affairs, Inc., Worchester, MA
Word Ambassadors, Fort Worth, TX
WSC Community Development Corp., Philadelphia, PA
Yella Gal Productions, Huntsville, AL
Zion Community Empowerment Center, College Park, GA

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

Rules for Property Produced in a Farming Business; Correction

Announcement 2000-88

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to removal of final regulations.

SUMMARY: This document contains corrections to a removal of final regulations relating to the application of section 263A of the Internal Revenue Code to property production in the trade or business of farming. This document was published in the **Federal Register** on August 21, 2000 (65 F.R. 50638).

EFFECTIVE DATE: August 21, 2000

FOR FURTHER INFORMATION CONTACT: Grant D. Anderson (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Need for Correction

As published, the final regulations (TD 8897, 2000–36 I.R.B. 234) contain errors that may prove to be misleading and are in need of clarification.

Correction of Publication

Accordingly, the publication of the final regulations (TD 8897), which were the subject of FR Doc. 00-21103, is corrected as follows:

1. On page 50638, column 3, in the preamble under the paragraph heading, "Background", line 3, the language proposed rulemaking (REG-208151-91) is corrected to read "proposed rulemaking (REG-209316-86)".

2. On page 50640, column 3, paragraph 1, line 14, the language "I.R.B. (Sept. 5, 2000)) issued" is corrected to read "I.R.B. 256 (Sept. 5, 2000)) issued".

Part 1–[CORRECTED]

§1.263A–1 [CORRECTED]

3. On page 50644, column 2, in amendatory instruction Par. 5., remove item designations for items "1." and "2." and correctly designate the items "2." and "3.", respectively.

Add new item "1." to read as follows:

1. The last sentence of paragraph (a)(3)(v) is revised.

4. On page 50644, column 2, §1.263A-1, remove the five asterisks following the section heading and add the following language for the last sentence of paragraph (a)(3)(v) to read as follows:

§1.263A-1 Uniform capitalization of costs.

(a) * * *

(3) * * *

(v) * * * See sections 263A(d) and 263A(e) and §1.263A-4 for rules relating to taxpayers engaged in a farming business.

* * * * *

§1.263A–4 [CORRECTED]

5. On page 50644, column 3, §1.263A-4, paragraph (a)(2)(i)(B), line 3, the language "disbursements method under section" is corrected to read "disbursements method of accounting (cash method) under section".

6. On page 50648, column 3, § 1.263A-4, paragraph (d)(2), line 5 from the top of the column, the language "required to use the accrual method" is corrected to read "required to use an accrual method".

Cynthia E. Grigsby,
Chief, Regulations Unit,
Office of Special Counsel (Modernization & Strategic Planning).

(Filed by the Office of the Federal Register on October 13, 2000, 8:45 a.m., and published in the issue of the Federal Register for October 16, 2000, 65 F.R. 61091)

Definition of Terms

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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