

## **HIGHLIGHTS OF THIS ISSUE**

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

### **INCOME TAX**

#### **Rev. Rul. 2004-35, page 640.**

**LIFO; price indexes; department stores.** The January 2004 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, January 31, 2004.

#### **REG-165579-02, page 651.**

Proposed regulations under section 368 of the Code clarify that a transferor may transfer, after a reorganization, assets or stock to a transferee controlled by the transferor. The regulations also make conforming changes relating to continuity of business enterprise and to the definition of a party to a reorganization.

#### **REG-166012-02, page 655.**

Proposed regulations under section 446 of the Code relate to the inclusion into income or deduction of a contingent nonperiodic payment made pursuant to a notional principal contract. The regulations also contain rules relating to the character of payments made pursuant to notional principal contracts, bullet swaps, and forward contracts. In general, contingent nonperiodic payments are accounted for under the noncontingent swap method or under an elective mark-to-market regime. With respect to character, the regulations provide ordinary treatment for most notional principal contract payments. As a general exception to ordinary treatment, the regulations provide capital treatment for termination payments. The regulations also provide capital treatment for payments made pursuant to bullet swaps and forward contracts. A public hearing is scheduled for May 25, 2004.

#### **Announcement 2004-20, page 673.**

Publication 1542, *Per Diem Rates (For Travel Within the Continental United States)*, will now be revised each time new *per diem* rates are announced. All revisions will be available on the IRS website. Paper copies will be available by request only.

### **EMPLOYEE PLANS**

#### **Notice 2004-24, page 642.**

**Weighted average interest rate update.** The weighted average interest rate for March 2004 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

### **EXEMPT ORGANIZATIONS**

#### **Announcement 2004-19, page 668.**

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

#### **Announcement 2004-23, page 673.**

Foundation to Save Our Children's Environment of Tulsa, OK, no longer qualifies as an organization to which contributions are deductible under section 170 of the Code.

(Continued on the next page)

Finding Lists begin on page ii.

Index for January through March begins on page iv.



## **ADMINISTRATIVE**

### **Rev. Proc. 2004–20, page 642.**

**Automobile owners and lessees.** This procedure provides owners and lessees of passenger automobiles (including trucks, vans, and electric automobiles) with tables detailing the limitations on depreciation deductions for passenger automobiles first placed in service during calendar year 2004 and the amounts to be included in income for passenger automobiles first leased during calendar year 2004. Separate tables are provided for passenger automobiles qualifying for additional first-year bonus depreciation under section 168(k). In addition, this procedure provides the maximum allowable value of employer-provided automobiles first made available to employees for personal use in calendar year 2004 for which the vehicle cents-per-mile valuation rule provided under section 1.61–21(e) of the regulations may be applicable.

### **Announcement 2004–16, page 668.**

The Service announces that Form 3115, *Application for Change in Accounting Method*, and its instructions were revised December 2003. This revision is the current version of Form 3115 used to request a change in accounting method. Rev. Procs. 2001–10, 2001–23, 2002–9, and 2002–28 modified.

### **Announcement 2004–21, page 673.**

The Service announces that an updated edition of Publication 538, *Accounting Periods and Methods*, (revised March 2004) is now available.

# The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by

applying the tax law with integrity and fairness to all.

## Introduction

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

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations,

court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last 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 last Bulletin of each semiannual period.\*

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

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\* **Beginning with Internal Revenue Bulletin 2003-43**, we are publishing the index at the end of the month, rather than at the beginning.

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

## Section 61.—Gross Income Defined

26 CFR 1.61-21: *Taxation of fringe benefits.*

This procedure provides the maximum value of employer-provided automobiles first made available to employees for personal use in calendar year 2004 for which the vehicle cents-per-mile valuation rule provided under § 1.61-21(e) of the Income Tax Regulations may be applicable. See Rev. Proc. 2004-20, page 642.

## Section 168.—Accelerated Cost Recovery System

This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2004 that qualify for the additional first-year bonus depreciation allowance under section 168(k) of the Code. See Rev. Proc. 2004-20, page 642.

## Section 280F.—Limitation on Depreciation for Luxury Automobiles; Limitation Where Certain Property Used for Personal Purposes

26 CFR 1.280F-7: *Property leased after December 31, 1986.*

This procedure provides owners and lessees of passenger automobiles (including electric automobiles) with tables detailing the limitations on depreciation deductions for automobiles first placed in service during calendar year 2004 and the amounts to be included in income for automobiles first leased during calendar year 2004. See Rev. Proc. 2004-20, page 642.

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

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

**LIFO; price indexes; department stores.** The January 2004 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories

for tax years ended on, or with reference to, January 31, 2004.

## Rev. Rul. 2004-35

The following Department Store Inventory Price Indexes for January 2004 were issued by the Bureau of Labor Statistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, January 31, 2004.

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

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

Groups	Jan. 2003	Jan. 2004	Percent Change from Jan. 2003 to Jan. 2004 <sup>1</sup>
1. Piece Goods . . . . .	465.2	468.0	0.6
2. Domestic and Draperies . . . . .	566.8	543.5	-4.1
3. Women's and Children's Shoes . . . . .	648.4	599.6	-7.5
4. Men's Shoes . . . . .	876.7	849.6	-3.1
5. Infants' Wear . . . . .	593.8	578.1	-2.6
6. Women's Underwear . . . . .	524.0	504.8	-3.7
7. Women's Hosiery . . . . .	339.8	350.5	3.1
8. Women's and Girls' Accessories . . . . .	549.7	544.8	-0.9
9. Women's Outerwear and Girls' Wear . . . . .	338.3	335.6	-0.8
10. Men's Clothing . . . . .	550.9	530.7	-3.7
11. Men's Furnishings . . . . .	567.3	574.2	1.2
12. Boys' Clothing and Furnishings . . . . .	427.1	416.3	-2.5
13. Jewelry . . . . .	866.4	888.4	2.5
14. Notions . . . . .	782.8	788.2	0.7
15. Toilet Articles and Drugs . . . . .	971.1	981.0	1.0
16. Furniture and Bedding . . . . .	626.3	617.5	-1.4
17. Floor Coverings . . . . .	593.0	595.4	0.4
18. Housewares . . . . .	736.4	710.7	-3.5
19. Major Appliances . . . . .	220.0	205.5	-6.6
20. Radio and Television . . . . .	47.1	43.5	-7.6

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

Groups	Jan. 2003	Jan. 2004	Percent Change from Jan. 2003 to Jan. 2004 <sup>1</sup>
21. Recreation and Education <sup>2</sup> .....	84.2	81.3	-3.4
22. Home Improvements <sup>2</sup> .....	125.5	127.7	1.8
23. Automotive Accessories <sup>2</sup> .....	112.0	112.3	0.3
Groups 1-15: Soft Goods .....	552.0	545.3	-1.2
Groups 16-20: Durable Goods .....	403.0	386.5	-4.1
Groups 21-23: Misc. Goods <sup>2</sup> .....	95.3	93.6	-1.8
Store Total <sup>3</sup> .....	497.8	488.6	-1.8

<sup>1</sup>Absence of a minus sign before the percentage change in this column signifies a price increase.

<sup>2</sup>Indexes on a January 1986 = 100 base.

<sup>3</sup>The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco and contract departments.

**DRAFTING INFORMATION**

The principal author of this revenue ruling is Michael Burkom of the Office

of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Burkom at (202) 622-7924 (not a toll-free call).

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rate Update

### Notice 2004-24

Sections 412(b)(5)(B) and 412(l)(7)(C)(i) of the Internal Revenue Code provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) must be within a permissible range around the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year.

Notice 88-73, 1988-2 C.B. 383, provides guidelines for determining the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability.

Section 417(e)(3)(A)(ii)(II) of the Code defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)-1(d)(3) of the Income Tax Regulations provides that the ap-

plicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

The rate of interest on 30-year Treasury Securities for February 2004 is 4.93 percent. Pursuant to Notice 2002-26, 2002-1 C.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
March	2004	5.21	4.69 to 5.47	4.69 to 5.73

### Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice, please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 1-202-283-9703. Mr. Montanaro may be reached at 1-202-283-9714. The telephone numbers in the preceding sentences are not toll-free.

*26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.*  
(Also, Part I, §§ 61, 168, 280F; 1.61-21, 1.280F-7.)

### Rev. Proc. 2004-20

#### SECTION 1. PURPOSE

01. This revenue procedure provides: (1) limitations on depreciation deductions for owners of passenger automobiles first placed in service by the taxpayer during

calendar year 2004, including special tables of limitations on depreciation deductions for trucks and vans, and for passenger automobiles designed to be propelled primarily by electricity and built by an original equipment manufacturer (electric automobiles); (2) the amounts to be included in income by lessees of passenger automobiles first leased by the taxpayer during calendar year 2004, including a separate table of inclusion amounts for lessees of trucks and vans, and a separate table for lessees of electric automobiles; and (3) the maximum allowable value of employer-provided passenger automobiles first made available to employees for personal use in calendar year 2004 for which the vehicle cents-per-mile valuation rule provided under § 1.61-21(e) of the Income Tax Regulations may be applicable.

02. This revenue procedure also provides tables of dollar limitations on depreciation deductions for owners of passenger automobiles to which the additional 50 percent first-year allowance for depreciation available under § 168(k)(4) applies, including special tables of limitations on depreciation deductions for qualifying trucks and vans and for qualifying electric automobiles. For purposes of these tables, the additional 50 percent first-year allowance does not apply if the taxpayer

has elected under § 168(k)(2)(C)(iii) not to take the additional allowance.

03. The tables detailing these depreciation limitations and lessee inclusion amounts reflect the automobile price inflation adjustments required by § 280F(d)(7). The maximum allowable passenger automobile value for applying the vehicle cents-per-mile valuation rule reflects the automobile price inflation adjustment of § 280F(d)(7) of the Internal Revenue Code, as required by § 1.61-21(e)(1)(iii)(A).

#### SECTION 2. BACKGROUND

01. For owners of passenger automobiles, § 280F(a) imposes dollar limitations on the depreciation deduction for the year that the passenger automobile is placed in service by the taxpayer and each succeeding year. In the case of electric automobiles placed in service after August 5, 1997, and before January 1, 2007, § 280F(a)(1)(C) requires tripling of these limitation amounts. Section 280F(d)(7) requires the amounts allowable as depreciation deductions to be increased by a price inflation adjustment amount for passenger automobiles placed in service after 1988. The method of calculating this price inflation amount for trucks and vans

placed in service in or after calendar year 2003 uses a different CPI “automobile component” (the “new trucks” component) than that used in the price inflation amount calculation for other passenger automobiles (the “new cars” component), resulting in somewhat higher depreciation deductions for trucks and vans. This change reflects the higher rate of price inflation that trucks and vans have been subject to since 1988. For purposes of this revenue procedure, the term “trucks and vans” refers to passenger automobiles that are built on a truck chassis, including minivans and sport utility vehicles (SUVs) that are built on a truck chassis.

02. Section 101 of the Job Creation and Worker Assistance Act of 2002, Pub. L. No. 107-147, 116 Stat. 21 (March 9, 2002) added § 168(k) to the Code. Generally, § 168(k)(1)(A) provides an additional 30 percent first-year depreciation deduction for new property acquired by the taxpayer after September 10, 2001, and before September 11, 2004 (subsequently extended to January 1, 2005), so long as no written binding contract for the acquisition of the property existed prior to September 11, 2001.

03. Section 201 of the Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, 117 Stat. 752 (May 28, 2003) added § 168(k)(4) to the Code. Section 168(k)(4)(A)(i) provides that § 168(k)(1) is applied by substituting “50 percent” for “30 percent” for new property acquired by the taxpayer after May 5, 2003, and before January 1, 2005, so long as no written binding contract for the acquisition of the property existed prior to May 6, 2003. In the case of a passenger automobile to which the 50 percent additional allowance applies (or would apply but for an election under § 168(k)(4)(E)) and for which no election has been made under § 168(k)(2)(C)(iii), § 168(k)(4)(D) increases the first-year depreciation allowed under § 280F(a)(1)(A) by \$7,650. For purposes of this revenue procedure, a passenger automobile to which the additional 50 percent first-year allowance under § 168(k)(4) applies (or would apply but for an election under § 168(k)(4)(E)) and for which no election has been made under § 168(k)(2)(C)(iii) is referred to as a “§ 168(k)(4) passenger automobile”.

04. For leased passenger automobiles, § 280F(c) requires a reduction in the de-

duction allowed to the lessee of the passenger automobile. The reduction must be substantially equivalent to the limitations on the depreciation deductions imposed on owners of passenger automobiles. Under § 1.280F-7(a), this reduction requires the lessees to include in gross income an inclusion amount determined by applying a formula to the amount obtained from a table. There is a table for lessees of electric automobiles, a table for lessees of trucks and vans, and a table for all other passenger automobiles. Each table shows inclusion amounts for a range of fair market values for each tax year after the passenger automobile is first leased. These tables should also be used by lessees of § 168(k)(4) passenger automobiles.

05. For passenger automobiles (including trucks, vans, and electric automobiles) first provided by employers to employees that meet the requirements of § 1.61-21(e)(1), the value to the employee of the use of the passenger automobile may be determined under the vehicle cents-per-mile valuation rule of § 1.61-21(e). Section 1.61-21(e)(1)(iii)(A) provides that for a passenger automobile first made available after 1988 to any employee of the employer for personal use, the value of the use of the passenger automobile may not be determined under the vehicle cents-per-mile valuation rule for a calendar year if the fair market value of the passenger automobile (determined pursuant to § 1.61-21(d)(5)(i) through (iv)) on the first date the passenger automobile is made available to the employee exceeds \$12,800 as adjusted by § 280F(d)(7).

### SECTION 3. SCOPE

01. The limitations on depreciation deductions in section 4.02(2) of this revenue procedure apply to passenger automobiles (other than leased passenger automobiles) that are placed in service by the taxpayer in calendar year 2004, and continue to apply for each tax year that the passenger automobile remains in service.

02. The tables in section 4.03 of this revenue procedure apply to leased passenger automobiles for which the lease term begins during calendar year 2004. Lessees of such passenger automobiles must use these tables to determine the inclusion amount for each tax year during which

the passenger automobile is leased. See Rev. Proc. 2002-14, 2002-1 C.B. 450, for passenger automobiles first leased before January 1, 2003, and Rev. Proc. 2003-75, 2003-2 C.B. 1018, for passenger automobiles first leased during calendar year 2003.

03. The maximum fair market value figure in section 4.04(2) of this revenue procedure applies to employer-provided passenger automobiles first made available to any employee for personal use in calendar year 2004. See Rev. Proc. 2002-14 for the maximum fair market value figure for passenger automobiles first made available before January 1, 2003, and Rev. Proc. 2003-75 for passenger automobiles first made available during calendar year 2003.

### SECTION 4. APPLICATION

#### 01. In General.

(1) Limitations on Depreciation Deductions for Certain Automobiles. The limitations on depreciation deductions for passenger automobiles placed in service by the taxpayer for the first time during calendar year 2004 are found in Tables 1 through 9 in section 4.02(2) of this revenue procedure. Table 1 of this revenue procedure provides limitations on depreciation deductions for a passenger automobile (other than a truck, van, electric automobile, or § 168(k)(4) passenger automobile). Table 2 of this revenue procedure provides limitations on depreciation deductions for a § 168(k)(4) passenger automobile (other than a truck, van, or electric automobile). Table 3 of this revenue procedure provides limitations on depreciation deductions for a truck or van (other than a § 168(k)(4) passenger automobile). Table 4 of this revenue procedure provides limitations on depreciation deductions for a truck or van that is a § 168(k)(4) passenger automobile. Table 5 of this revenue procedure provides limitations on depreciation deductions for an electric automobile (other than a § 168(k)(4) passenger automobile). Table 6 of this revenue procedure provides limitations on depreciation deductions for an electric automobile that is a § 168(k)(4) passenger automobile.

(2) Inclusions in Income of Lessees of Passenger Automobiles. A taxpayer first leasing a passenger automobile during calendar year 2004 must determine the inclu-

sion amount that is added to gross income using the tables in section 4.03 of this revenue procedure. The inclusion amount is determined using Table 7 in the case of a passenger automobile (other than a truck, van, or electric automobile), Table 8 in the case of a truck or van, and Table 9 in the case of an electric automobile. In addition, the procedures of § 1.280F-7(a) must be followed.

(3) Maximum Automobile Value for Using the Cents-per-mile Valuation Rule. An employer providing a passenger automobile for the first time in calendar year 2004 for the personal use of any employee may determine the value of the use of the passenger automobile by using the cents-per-mile valuation rule in § 1.61-21(e) if the fair market value of the passenger automobile does not exceed the amount specified in section 4.04(2) of this revenue procedure. If the fair market value of the passenger automobile exceeds the amount specified in section 4.04(2) of this revenue procedure, the employer may determine the value of the use of the passenger automobile under the general valuation rules of § 1.61-21(b) or under the special valuation rules of § 1.61-21(d) (Automobile lease valuation) or § 1.61-21(f) (Commuting valuation) if the applicable requirements are met.

02. Limitations on Depreciation Deductions for Certain Automobiles.

(1) Amount of the Inflation Adjustment. Under § 280F(d)(7)(B)(i), the automobile price inflation adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. The term

“CPI automobile component” is defined in § 280F(d)(7)(B)(ii) as the “automobile component” of the Consumer Price Index for all Urban Consumers published by the Department of Labor (the CPI). The new car component of the CPI was 115.2 for October 1987 and 133.5 for October 2003. The October 2003 index exceeded the October 1987 index by 18.3. The Service has, therefore, determined that the automobile price inflation adjustment for 2004 for passenger automobiles (other than trucks and vans) is 15.89 percent ( $18.3/115.2 \times 100\%$ ). This adjustment is applicable to all passenger automobiles (other than trucks and vans) that are first placed in service in calendar year 2004. The dollar limitations in § 280F(a) must therefore be multiplied by a factor of 0.1589, and the resulting increases, after rounding to the nearest \$100, are added to the 1988 limitations to give the depreciation limitations applicable to passenger automobiles (other than trucks, vans, and electric automobiles) for calendar year 2004. To determine the dollar limitations applicable to an electric automobile first placed in service during calendar year 2004, the dollar limitations in § 280F(a) are tripled in accordance with § 280F(a)(1)(C) and are then multiplied by a factor of 0.1588; the resulting increases, after rounding to the nearest \$100, are added to the tripled 1988 limitations to give the depreciation limitations for calendar year 2004. To determine the dollar limitations applicable to trucks and vans first placed in service during calendar year 2004, the new truck component of the CPI is used instead of the new car component. The new truck component of the CPI was 112.4 for October 1987 and 144.6 for October 2003. The October

2003 index exceeded the October 1987 index by 32.2. The Service has, therefore, determined that the automobile price inflation adjustment for 2004 for trucks and vans is 28.65 percent ( $32.2/112.4 \times 100\%$ ). This adjustment is applicable to all trucks and vans that are first placed in service in calendar year 2004. The dollar limitations in § 280F(a) must therefore be multiplied by a factor of 0.2865, and the resulting increases, after rounding to the nearest \$100, are added to the 1988 limitations to give the depreciation limitations applicable to trucks and vans.

(2) Amount of the Limitation. For passenger automobiles placed in service by the taxpayer in calendar year 2004, Tables 1 through 6 contain the dollar amount of the depreciation limitation for each tax year. Use Table 1 for passenger automobiles (other than trucks, vans, electric automobiles, and § 168(k)(4) passenger automobiles) placed in service by the taxpayer in calendar year 2004. Use Table 2 for § 168(k)(4) passenger automobiles (other than trucks, vans, and electric automobiles) placed in service by the taxpayer in calendar year 2004. Use Table 3 for trucks and vans (other than § 168(k)(4) passenger automobiles) placed in service by the taxpayer in calendar year 2004. Use Table 4 for trucks or vans that are § 168(k)(4) passenger automobiles placed in service by the taxpayer in calendar year 2004. Use Table 5 for electric automobiles (other than § 168(k)(4) passenger automobiles) placed in service by the taxpayer in calendar year 2004. Use Table 6 for electric automobiles that are § 168(k)(4) passenger automobiles placed in service by the taxpayer in calendar year 2004.

REV. PROC. 2004-20 TABLE 1

DEPRECIATION LIMITATIONS FOR PASSENGER AUTOMOBILES  
(THAT ARE NOT § 168(k)(4) PASSENGER AUTOMOBILES,  
TRUCKS, VANS, OR ELECTRIC AUTOMOBILES)  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$2,960
2nd Tax Year	\$4,800
3rd Tax Year	\$2,850
Each Succeeding Year	\$1,675

REV. PROC. 2004-20 TABLE 2

DEPRECIATION LIMITATIONS FOR § 168(k)(4) PASSENGER AUTOMOBILES  
(THAT ARE NOT TRUCKS, VANS, OR ELECTRIC AUTOMOBILES)  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$10,610
2nd Tax Year	\$4,800
3rd Tax Year	\$2,850
Each Succeeding Year	\$1,675

REV. PROC. 2004-20 TABLE 3

DEPRECIATION LIMITATIONS FOR TRUCKS AND VANS  
(THAT ARE NOT § 168(k)(4) PASSENGER AUTOMOBILES)  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$3,260
2nd Tax Year	\$5,300
3rd Tax Year	\$3,150
Each Succeeding Year	\$1,875

REV. PROC. 2004-20 TABLE 4

DEPRECIATION LIMITATIONS FOR TRUCKS AND VANS  
THAT ARE § 168(k)(4) PASSENGER AUTOMOBILES  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$10,910
2nd Tax Year	\$5,300
3rd Tax Year	\$3,150
Each Succeeding Year	\$1,875

REV. PROC. 2004-20 TABLE 5

DEPRECIATION LIMITATIONS FOR ELECTRIC AUTOMOBILES  
(THAT ARE NOT § 168(k)(4) PASSENGER AUTOMOBILES)  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$8,880
2nd Tax Year	\$14,300
3rd Tax Year	\$8,550
Each Succeeding Year	\$5,125

REV. PROC. 2004-20 TABLE 6

DEPRECIATION LIMITATIONS FOR ELECTRIC AUTOMOBILES  
THAT ARE § 168(k)(4) PASSENGER AUTOMOBILES  
PLACED IN SERVICE BY THE TAXPAYER DURING CALENDAR YEAR 2004

<i>Tax Year</i>	<i>Amount</i>
1st Tax Year	\$31,830
2nd Tax Year	\$14,300
3rd Tax Year	\$8,550
Each Succeeding Year	\$5,125

03. Inclusions in Income of Lessees of Passenger Automobiles.

The inclusion amounts for passenger automobiles (including § 168(k)(1) passenger automobiles and § 168(k)(4) passenger automobiles) first leased in cal-

endar year 2004 are calculated under the procedures described in § 1.280F-7(a). Lessees of passenger automobiles other than trucks, vans, and electric automobiles should use Table 7 of this revenue procedure in applying these procedures,

while lessees of trucks and vans should use Table 8 of this revenue procedure and lessees of electric automobiles should use Table 9 of this revenue procedure.

REV. PROC. 2004-20 TABLE 7

DOLLAR AMOUNTS FOR PASSENGER AUTOMOBILES  
(THAT ARE NOT TRUCKS, VANS, OR ELECTRIC AUTOMOBILES)  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Passenger Automobile		Tax Year During Lease				
		1st	2nd	3rd	4th	5th & Later
Over	Not Over					
\$17,500	18,000	11	23	33	42	48
18,000	18,500	13	26	40	49	56
18,500	19,000	14	31	46	55	65
19,000	19,500	16	35	51	63	73
19,500	20,000	18	39	57	70	81
20,000	20,500	20	43	63	77	89
20,500	21,000	22	47	69	84	97
21,000	21,500	23	51	75	91	106
21,500	22,000	25	55	81	98	114
22,000	23,000	28	61	90	109	126
23,000	24,000	32	69	102	123	142
24,000	25,000	35	77	114	137	159
25,000	26,000	39	85	126	151	176
26,000	27,000	43	93	137	166	192
27,000	28,000	46	101	149	180	209
28,000	29,000	50	109	161	194	225
29,000	30,000	54	116	174	208	242
30,000	31,000	57	125	185	223	257
31,000	32,000	61	133	197	237	274
32,000	33,000	64	141	209	251	291
33,000	34,000	68	149	221	265	307
34,000	35,000	72	157	232	280	323
35,000	36,000	75	165	244	294	340
36,000	37,000	79	173	256	308	357
37,000	38,000	83	181	268	322	373
38,000	39,000	86	189	280	337	389
39,000	40,000	90	197	292	351	405
40,000	41,000	94	204	304	365	423
41,000	42,000	97	213	316	379	438
42,000	43,000	101	221	327	394	455

## REV. PROC. 2004-20 TABLE 7

DOLLAR AMOUNTS FOR PASSENGER AUTOMOBILES  
(THAT ARE NOT TRUCKS, VANS, OR ELECTRIC AUTOMOBILES)  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Passenger Automobile		Tax Year During Lease				
		1st	2nd	3rd	4th	5th & Later
Over	Not Over					
43,000	44,000	105	228	340	408	471
44,000	45,000	108	237	351	422	488
45,000	46,000	112	245	363	436	504
46,000	47,000	115	253	375	451	520
47,000	48,000	119	261	387	464	538
48,000	49,000	123	269	398	479	554
49,000	50,000	126	277	411	493	570
50,000	51,000	130	285	422	508	586
51,000	52,000	134	292	435	522	603
52,000	53,000	137	301	446	536	619
53,000	54,000	141	309	458	550	636
54,000	55,000	145	316	471	564	652
55,000	56,000	148	325	482	578	669
56,000	57,000	152	333	493	593	685
57,000	58,000	155	341	506	607	701
58,000	59,000	159	349	517	622	718
59,000	60,000	163	357	529	636	734
60,000	62,000	168	369	547	657	759
62,000	64,000	176	384	571	686	792
64,000	66,000	183	401	594	714	825
66,000	68,000	190	417	618	743	857
68,000	70,000	197	433	642	771	890
70,000	72,000	205	448	666	800	923
72,000	74,000	212	465	689	828	956
74,000	76,000	219	481	713	856	990
76,000	78,000	227	496	738	884	1,022
78,000	80,000	234	513	760	914	1,055
80,000	85,000	247	540	803	963	1,112
85,000	90,000	265	580	862	1,035	1,194
90,000	95,000	283	621	921	1,105	1,277
95,000	100,000	301	661	980	1,177	1,359
100,000	110,000	328	721	1,069	1,284	1,482
110,000	120,000	365	800	1,189	1,426	1,646
120,000	130,000	401	881	1,307	1,568	1,811
130,000	140,000	438	960	1,426	1,711	1,975
140,000	150,000	474	1,041	1,544	1,853	2,140
150,000	160,000	511	1,120	1,663	1,996	2,304
160,000	170,000	547	1,200	1,782	2,138	2,468
170,000	180,000	583	1,281	1,900	2,280	2,633
180,000	190,000	620	1,360	2,020	2,422	2,797
190,000	200,000	656	1,440	2,139	2,564	2,962
200,000	210,000	693	1,520	2,257	2,707	3,126
210,000	220,000	729	1,600	2,376	2,849	3,291
220,000	230,000	765	1,681	2,494	2,991	3,455
230,000	240,000	802	1,760	2,613	3,134	3,619
240,000	250,000	838	1,840	2,732	3,276	3,784

## REV. PROC. 2004-20 TABLE 8

DOLLAR AMOUNTS FOR TRUCKS AND VANS  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Truck or Van		Tax Year During Lease				
		1st	2nd	3rd	4th	5th and Later
Over \$18,000	Not Over \$18,500	7	15	21	26	30
18,500	19,000	9	18	28	33	38
19,000	19,500	11	22	34	40	47
19,500	20,000	13	26	39	48	55
20,000	20,500	14	31	45	54	63
20,500	21,000	16	35	51	61	72
21,000	21,500	18	38	58	68	80
21,500	22,000	20	42	63	76	88
22,000	23,000	23	48	72	87	100
23,000	24,000	26	57	83	101	117
24,000	25,000	30	64	96	115	133
25,000	26,000	34	72	108	129	149
26,000	27,000	37	81	119	143	166
27,000	28,000	41	88	132	157	183
28,000	29,000	44	97	143	172	198
29,000	30,000	48	104	155	187	215
30,000	31,000	52	112	167	201	231
31,000	32,000	55	121	178	215	248
32,000	33,000	59	128	191	229	264
33,000	34,000	63	136	203	243	281
34,000	35,000	66	145	214	257	298
35,000	36,000	70	152	227	271	314
36,000	37,000	74	160	238	286	330
37,000	38,000	77	169	249	301	346
38,000	39,000	81	176	262	314	364
39,000	40,000	84	185	273	329	379
40,000	41,000	88	192	286	343	396
41,000	42,000	92	200	298	357	412
42,000	43,000	95	209	309	371	429
43,000	44,000	99	216	322	385	445
44,000	45,000	103	224	333	400	462
45,000	46,000	106	233	345	413	479
46,000	47,000	110	240	357	428	495
47,000	48,000	114	248	369	442	511
48,000	49,000	117	257	380	457	527
49,000	50,000	121	264	393	471	544
50,000	51,000	125	272	404	486	560
51,000	52,000	128	280	417	499	577
52,000	53,000	132	288	428	514	593
53,000	54,000	135	297	440	527	610
54,000	55,000	139	304	452	542	626
55,000	56,000	143	312	464	556	643
56,000	57,000	146	321	475	571	659
57,000	58,000	150	328	488	585	675
58,000	59,000	154	336	499	600	691
59,000	60,000	157	345	511	613	708
60,000	62,000	163	356	529	635	733
62,000	64,000	170	372	553	663	766
64,000	66,000	177	389	576	692	798
66,000	68,000	185	404	600	720	832
68,000	70,000	192	420	624	749	864
70,000	72,000	199	436	648	777	897
72,000	74,000	206	453	671	805	931
74,000	76,000	214	468	695	834	963
76,000	78,000	221	484	719	863	996

## REV. PROC. 2004-20 TABLE 8

DOLLAR AMOUNTS FOR TRUCKS AND VANS  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Truck or Van		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
78,000	80,000	228	501	742	891	1,029
80,000	85,000	241	528	785	940	1,087
85,000	90,000	259	568	844	1,012	1,168
90,000	95,000	277	609	902	1,084	1,250
95,000	100,000	296	648	962	1,155	1,333
100,000	110,000	323	708	1,052	1,261	1,456
110,000	120,000	359	788	1,171	1,403	1,620
120,000	130,000	396	868	1,289	1,546	1,785
130,000	140,000	432	948	1,408	1,688	1,949
140,000	150,000	469	1,028	1,526	1,831	2,113
150,000	160,000	505	1,108	1,645	1,973	2,278
160,000	170,000	541	1,188	1,764	2,115	2,443
170,000	180,000	578	1,268	1,882	2,258	2,607
180,000	190,000	614	1,348	2,001	2,400	2,771
190,000	200,000	651	1,428	2,120	2,542	2,936
200,000	210,000	687	1,508	2,239	2,684	3,100
210,000	220,000	724	1,588	2,357	2,827	3,264
220,000	230,000	760	1,668	2,476	2,969	3,429
230,000	240,000	796	1,748	2,595	3,112	3,593
240,000	250,000	833	1,828	2,713	3,254	3,758

## REV. PROC. 2004-20 TABLE 9

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Electric Automobile		Tax Year During Lease				
Over	Not Over	1st	2nd	3rd	4th	5th and Later
\$53,000	\$54,000	33	72	106	127	147
54,000	55,000	37	79	118	142	164
55,000	56,000	40	88	130	155	180
56,000	57,000	44	96	141	170	197
57,000	58,000	48	103	154	184	213
58,000	59,000	51	112	165	199	229
59,000	60,000	55	120	177	213	245
60,000	62,000	60	132	195	234	270
62,000	64,000	68	147	219	263	303
64,000	66,000	75	164	242	291	336
66,000	68,000	82	180	266	320	369
68,000	70,000	90	195	290	348	402
70,000	72,000	97	211	314	377	435
72,000	74,000	104	228	337	405	468
74,000	76,000	111	244	361	434	500
76,000	78,000	119	259	385	462	534
78,000	80,000	126	275	409	491	566
80,000	85,000	139	303	451	540	624
85,000	90,000	157	343	510	612	706
90,000	95,000	175	384	569	682	788
95,000	100,000	193	424	628	754	870
100,000	110,000	221	483	718	860	994
110,000	120,000	257	563	837	1,003	1,158
120,000	130,000	294	643	955	1,145	1,323
130,000	140,000	330	723	1,074	1,288	1,486

REV. PROC. 2004-20 TABLE 9

DOLLAR AMOUNTS FOR ELECTRIC AUTOMOBILES  
WITH A LEASE TERM BEGINNING IN CALENDAR YEAR 2004

Fair Market Value of Electric Automobile		Tax Year During Lease				
		1st	2nd	3rd	4th	5th and Later
Over	Not Over					
140,000	150,000	366	804	1,192	1,430	1,651
150,000	160,000	403	883	1,311	1,573	1,815
160,000	170,000	439	963	1,430	1,715	1,980
170,000	180,000	476	1,043	1,549	1,857	2,144
180,000	190,000	512	1,123	1,668	1,999	2,309
190,000	200,000	548	1,203	1,786	2,142	2,473
200,000	210,000	585	1,283	1,905	2,284	2,637
210,000	220,000	621	1,363	2,024	2,426	2,802
220,000	230,000	658	1,443	2,142	2,569	2,966
230,000	240,000	694	1,523	2,261	2,711	3,131
240,000	250,000	730	1,603	2,380	2,854	3,294

04. Maximum Automobile Value for Using the Cents-per-mile Valuation Rule.

(1) Amount of Adjustment. Under § 1.61-21(e)(1)(iii)(A), the limitation on the fair market value of an employer-provided passenger automobile first made available to any employee for personal use after 1988 is to be adjusted in accordance with § 280F(d)(7). Accordingly, the adjustment for any calendar year is the percentage (if any) by which the CPI automobile component for October of the preceding calendar year exceeds the CPI automobile component for October 1987. See, section 4.02(1) of this revenue procedure. The new car component of the CPI was 115.2 for October 1987 and 133.5 for October 2003. The October 2003 index exceeded the October 1987 index by 18.3. The Service has, therefore, determined that the adjustment for 2004 is 15.89 percent ( $18.3/115.2 \times 100\%$ ). This adjustment is applicable to all employer-provided passenger automobiles first made available to any employee for personal use in calendar

year 2004. The maximum fair market value specified in § 1.61-21(e)(1)(iii)(A) must therefore be multiplied by a factor of 0.1589, and the resulting increase, after rounding to the nearest \$100, is added to \$12,800 to give the maximum value for calendar year 2004.

(2) The Maximum Automobile Value. For passenger automobiles first made available in calendar year 2004 to any employee of the employer for personal use, the vehicle cents-per-mile valuation rule may be applicable if the fair market value of the passenger automobile on the date it is first made available does not exceed \$14,800.

SECTION 5. EFFECTIVE DATE

This revenue procedure applies to passenger automobiles (other than leased passenger automobiles) that are first placed in service by the taxpayer during calendar year 2004, to leased passenger automobiles that are first leased by the tax-

payer during calendar year 2004, and to employer-provided passenger automobiles first made available to employees for personal use in calendar year 2004.

SECTION 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Bernard P. Harvey of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding the depreciation limitations and lessee inclusion amounts in this revenue procedure, contact Bernard P. Harvey at (202) 622-3110 (not a toll-free call); for further information regarding the maximum automobile value for applying the vehicle cents-per-mile valuation rule, contact Dan E. Boeskin of the Office of the Associate Chief Counsel (Tax Exempt and Government Entities) at (202) 622-6040 (not toll-free calls).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking

### Corporate Reorganizations; Transfers of Assets or Stock Following a Reorganization

#### REG-165579-02

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance relating to the effect of certain asset and stock transfers on the qualification of certain transactions as reorganizations under section 368(a). This document also contains proposed regulations that provide guidance relating to the continuity of business enterprise requirement and the definition of a party to a reorganization. These regulations affect corporations and their shareholders.

DATES: Written or electronic comments and requests for a public hearing must be received by June 1, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-165579-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-165579-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Rebecca O. Burch, (202) 622-7550; concerning submissions and the hearing, Sonya Cruse, (202) 622-4693 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

To qualify as a reorganization under section 368 of the Internal Revenue Code, a transaction must satisfy certain statutory requirements and nonstatutory requirements, including continuity of business enterprise (COBE). Section 368(a)(2)(C) provides that a transaction otherwise qualifying as a reorganization under section 368(a)(1)(A), (B), (C), or (G) will not be disqualified by reason of the fact that part or all of the acquired assets or stock are transferred to a corporation controlled by the acquiring corporation.

Section 354(a) provides that, in general, no gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are, in pursuance of the plan of reorganization, exchanged solely for stock or securities in such corporation or in another corporation a party to the reorganization. Section 368(b) provides that the term "a party to a reorganization" includes a corporation resulting from a reorganization, and both corporations, in the case of a reorganization resulting from the acquisition by one corporation of stock or properties of another. Section 368(b) further provides that, in the case of a reorganization qualifying under section 368(a)(1)(B) or (C), if the stock exchanged for the stock or properties is stock of a corporation which is in control of the acquiring corporation, the term "a party to a reorganization" includes the corporation so controlling the acquiring corporation. In the case of a reorganization qualifying under section 368(a)(1)(A), (B), (C), or (G) by reason of section 368(a)(2)(C), the term "a party to a reorganization" includes the corporation controlling the corporation to which the acquired assets or stock are transferred. In the case of a reorganization qualifying under section 368(a)(1)(A) or (G) by reason of section 368(a)(2)(D), the term "a party to a reorganization" includes the controlling corporation. Finally, in the case of a reorganization qualifying under

section 368(a)(1)(A) by reason of section 368(a)(2)(E), the term "a party to a reorganization" includes the controlling corporation.

On January 28, 1998, final regulations providing guidance regarding the COBE requirement, the definition of "a party to the reorganization," and the effect of certain transfers of acquired assets or stock on the qualification of a transaction as a reorganization under section 368(a)(1)(A), (B), (C), or (G) were published in the **Federal Register** (T.D. 8760, 1998-1 C.B. 803 [63 FR 4174]). Sections 1.368-1(d) and 1.368-2(f) and (k) were among those regulations.

Section 1.368-1(d) generally provides that, for a transaction to satisfy the COBE requirement, the issuing corporation must either continue a significant historic business of the target corporation or use a significant portion of the target corporation's assets in a business. For this purpose, the term issuing corporation generally means the acquiring corporation, but, in the case of a triangular reorganization, it means the corporation in control of the acquiring corporation. In addition, the issuing corporation is treated as holding all of the businesses and assets of all of the members of the qualified group. For this purpose, the qualified group is one or more chains of corporations connected through stock ownership with the issuing corporation, but only if the issuing corporation owns directly stock meeting the requirements of section 368(c) in at least one other corporation, and stock meeting the requirements of section 368(c) in each of the corporations (except the issuing corporation) is owned directly by one of the other corporations.

Section 1.368-2(f) provides that the term "a party to a reorganization" includes a corporation resulting from a reorganization, and both corporations in a transaction qualifying as a reorganization where one corporation acquires stock or properties of another corporation. In the case of a triangular reorganization, a corporation controlling an acquiring corporation is

a party to the reorganization when the stock of such controlling corporation is used in the acquisition of properties. Section 1.368-2(f) further provides that, if a transaction otherwise qualifies as a reorganization, a corporation remains a party to the reorganization even though stock or assets acquired in the reorganization are transferred in a transaction described in §1.368-2(k).

Section 1.368-2(k) provides that, except as otherwise provided, a transaction otherwise qualifying as a reorganization under section 368(a)(1)(A), (B), (C), or (G) (where the requirements of sections 354(b)(1)(A) and (B) are met) will not be disqualified by reason of the fact that part or all of the assets or stock acquired in the transaction are transferred or successively transferred to one or more corporations controlled in each transfer by the transferor corporation. For this purpose, a corporation is a controlled corporation if the transferor corporation owns stock of such corporation constituting control within the meaning of section 368(c). Furthermore, a transaction qualifying under section 368(a)(1)(A) by reason of the application of section 368(a)(2)(E) is not disqualified by reason of the fact that part or all of the stock of the surviving corporation is transferred or successively transferred to one or more corporations controlled in each transfer by the transferor corporation, or because part or all of the assets of the surviving corporation or the merged corporation are transferred or successively transferred to one or more corporations controlled in each transfer by the transferor corporation. Again, for this purpose a corporation is controlled by the transferor corporation if the transferor corporation owns stock of such corporation constituting control within the meaning of section 368(c).

The preamble to the January 28, 1998, regulations explains that assets or stock acquired in certain reorganizations may be transferred among members of a qualified group, and in certain cases to partnerships, without preventing the reorganization from satisfying COBE. It also states that the IRS and Treasury Department believe that the COBE requirements adequately address the remote continuity of interest issues raised in *Groman v. Commissioner*, 302 U.S. 82 (1937), and *Helvering v. Bashford*, 302 U.S. 454 (1938), and,

therefore, that the final regulations do not separately articulate rules for remote continuity. The preamble also states that §1.368-1(d), being limited to a discussion of the COBE requirement, does not address satisfaction of the explicit statutory requirements of a reorganization, which is the subject of §1.368-2. Finally, the preamble states that no inference is to be drawn as to whether transactions not described in §1.368-2(k) otherwise qualify as reorganizations.

In Rev. Rul. 2001-24, 2001-1 C.B. 1290, and Rev. Rul. 2002-85, 2002-2 C.B. 986, the IRS addressed the effect of certain transfers not described in §1.368-2(k) on certain transactions that otherwise qualify as reorganizations. In Rev. Rul. 2001-24, the IRS considered whether a transfer of the stock of the acquiring corporation to a corporation wholly owned by the issuing corporation following a transaction that otherwise qualified as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D) (a forward triangular merger) prevented the transaction from qualifying as such. The IRS ruled that the transfer of stock of the acquiring corporation did not cause the issuing corporation to be treated as not in control of the acquiring corporation for purposes of section 368(a)(2)(D), and did not cause the issuing corporation to fail to be treated as a party to the reorganization. In arriving at these conclusions, the ruling notes that section 368(a)(2)(C) and §1.368-2(k) do not specifically address the facts of the ruling and section 368(a)(2)(C) does not preclude the transaction from qualifying as a reorganization. The ruling states that, by its terms, section 368(a)(2)(C) is a permissive, rather than an exclusive or restrictive, section. Therefore, the transfer of acquiring corporation stock to the issuing corporation's wholly owned subsidiary did not prevent the transaction from qualifying as a forward triangular merger.

In Rev. Rul. 2002-85, the IRS considered whether an acquiring corporation's transfer of acquired assets to a subsidiary controlled by the acquiring corporation would prevent the acquiring corporation's acquisition of those assets from qualifying as a reorganization under section 368(a)(1)(D). After noting that section 368(a)(2)(C) is permissive rather than exclusive or restrictive, the ruling reasons

that, because §1.368-2(k) restates and interprets section 368(a)(2)(C), §1.368-2(k) also should be viewed as permissive and not exclusive or restrictive. The ruling concludes that the absence of section 368(a)(1)(D) from §1.368-2(k) does not prevent a corporation from remaining a party to a reorganization even if the acquired stock or assets are transferred to a controlled subsidiary. The ruling states that, like reorganizations under sections 368(a)(1)(A) and 368(a)(1)(C), reorganizations under section 368(a)(1)(D) are asset reorganizations. In reorganizations under sections 368(a)(1)(A) and reorganizations under section 368(a)(1)(C), the original transferee is treated as a party to a reorganization, even if the acquired assets are transferred to a controlled subsidiary of the original transferee. Because the differences between reorganizations under section 368(a)(1)(D) on the one hand and reorganizations under sections 368(a)(1)(A) and (C) on the other hand do not warrant treating the original transferee in a transaction that otherwise satisfies the requirements of a reorganization under section 368(a)(1)(D) differently from the original transferee in a reorganization under section 368(a)(1)(A) or (C) for purposes of section 368(b), the ruling concludes that the original transferee in a transaction that otherwise satisfies the requirements of a reorganization under section 368(a)(1)(D) is treated as a party to the reorganization, notwithstanding the original transferee's transfer of acquired assets to a controlled subsidiary of the original transferee. The ruling concludes that the transaction qualifies as a reorganization under section 368(a)(1)(D).

### Explanation of Provisions

As described above, in the regulations under section 368 and in revenue rulings, the IRS and Treasury Department have considered the effect of transfers of assets or stock to controlled corporations on the qualification of a transaction as a reorganization in a variety of situations not addressed by section 368(a)(2)(C). In each of these cases, the IRS and Treasury Department have concluded that the transfers did not cause the transaction to fail to qualify as a reorganization. These conclusions reflect the fact that, in all of the situations considered, the transactions, in form, sat-

isfy the statutory requirements of a reorganization and, in substance, constitute readjustments of continuing interests in the reorganized business in modified corporate form. None of the transactions involve the transfer of the acquired stock or assets to a “stranger,” a result inconsistent with reorganization treatment. H.R. Rep. No. 83-1337, A134 (1954).

The IRS and Treasury believe that certain transfers of stock and assets to controlled corporations are consistent with reorganization treatment, even though in some cases the transfers involve a type of reorganization not included in section 368(a)(2)(C). The effect of transferring stock or assets to a controlled corporation on the qualification of a transaction as a reorganization should not depend on the specific reorganization provision at issue. Given that section 368(a)(2)(C) was intended to be permissive rather than exclusive with respect to certain transfers of stock or assets to a controlled corporation following a transaction that would qualify as a reorganization without regard to the transfer, the IRS and Treasury believe it is appropriate to extend its principles to certain transfers of stock and assets after all types of reorganizations.

Accordingly, these regulations propose to amend §1.368-2(k) to provide that a transaction otherwise qualifying as a reorganization under section 368(a) will not be disqualified as a result of the transfer or successive transfers to one or more corporations controlled in each transfer by the transferor corporation of part or all of (i) the assets of any party to the reorganization, or (ii) the stock of any party to the reorganization other than the issuing corporation. In addition, these proposed regulations include amendments to the COBE regulations under §1.368-1(d) and amendments to the definition of a party to a reorganization under §1.368-2(f) that reflect §1.368-2(k) as proposed.

### 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,

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 businesses.

### Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written (a signed original and 8 copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury Department request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying. A public hearing will be scheduled if requested in writing by any person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the public hearing will be published in the **Federal Register**.

### Drafting Information

The principal author of these proposed regulations is Rebecca O. Burch of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

### 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 continues to read in part as follows:

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

Par. 2. Section 1.368-1 is amended as follows:

1. Paragraph (d)(4)(i) is redesignated as paragraph (d)(4)(i)(A) and revised.
2. New paragraph (d)(4)(i)(B) is added.

3. Paragraph (d)(5), introductory text, is redesignated as paragraph (d)(5)(i), and revised.
4. In newly designated paragraph (d)(5)(i), Examples 7, 8, 9, 10, 11, and 12 are redesignated as Examples 8, 9, 10, 11, 12, and 13, respectively.
5. In newly designated paragraph (d)(5)(i), the first sentence in Examples 9, 10, and 12 is revised.
6. In newly designated paragraph (d)(5)(i), a new *Example 7* is added.
7. New paragraph (d)(5)(ii) is added.

The revisions and additions read as follows:

#### *§1.368-1 Purpose and scope of exception of reorganization exchanges.*

\* \* \* \* \*  
(d) \* \* \*

\* \* \* \* \*  
(4) \* \* \*

(i) *Businesses and assets of members of a qualified group—(A) In general.* The issuing corporation is treated as holding all of the businesses and assets of all of the members of the qualified group, as defined in paragraph (d)(4)(ii) of this section.

(B) *Special rule.* The issuing corporation is treated as holding all of the businesses and assets of the surviving corporation after a reorganization that otherwise satisfies the requirements of a reverse triangular merger (as defined in §1.358-6(b)(2)(iii)), the acquired corporation after a reorganization that otherwise satisfies the requirements of section 368(a)(1)(B), and the acquiring corporation after a reorganization that otherwise satisfies the requirements of a forward triangular merger (as defined in §1.358-6(b)(2)(i)), a triangular B reorganization (as defined in §1.358-6(b)(2)(iv)), a triangular C reorganization (as defined in §1.358-6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), provided that members of the qualified group own, in the aggregate, stock of the surviving, acquired, or acquiring corporation meeting the requirements of section 368(c). This

paragraph (d)(4)(i)(B) applies to transactions occurring after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

(5) *Examples.* (i) The following examples illustrate this paragraph (d). All the following corporations have only one class of stock outstanding.

\* \* \* \* \*

*Example 7.* (i) *Facts.* The facts are the same as in *Example 6*, except that, instead of P acquiring the assets of T, HC acquires all of outstanding stock of T in exchange solely for voting stock of P. In addition, as part of the plan of reorganization, HC transfers 10 percent of the stock of T to each of subsidiaries S-1 through S-10. Finally, T will continue to operate an auto parts distributorship. Without regard to whether the transaction satisfies the COBE requirement, the transaction qualifies as a triangular B reorganization.

(ii) *Continuity of business enterprise.* Under paragraph (d)(4)(i)(B) of this section, P is treated as holding all the assets and conducting the business of T because S-1 through S-10, members of the qualified group, own stock of T meeting the requirements of section 368(c). Therefore, the COBE requirement of paragraph (d)(1) of this section is satisfied because P is treated as continuing T's business.

\* \* \* \* \*

*Example 9.* (i) *Facts.* The facts are the same as *Example 8*, except that S-3 transfers the historic T business to PRS in exchange for a 1 percent interest in PRS.

\* \* \* \* \*

*Example 10.* (i) *Facts.* The facts are the same as *Example 8*, except that S-3 transfers the historic T business to PRS in exchange for a 33 1/3 percent interest in PRS, and no member of P's qualified group performs active and substantial management functions for the ski boot business operated in PRS.

\* \* \* \* \*

*Example 12.* (i) *Facts.* The facts are the same as *Example 11*, except that S-1 transfers all the T assets to PRS, and P and X each transfer cash to PRS in exchange for partnership interests. \* \* \*

\* \* \* \* \*

(ii) *Effective dates.* Paragraph (d)(5) *Example 6*, and *Example 8* through *Example 13* apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is binding on January 28, 1998, and at all times thereafter. Paragraph (d)(5) *Example 7* applies to transactions occurring after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

Par. 3. Section 1.368-2 is amended by:

1. Adding three sentences at the end of paragraph (f).

2. Revising paragraph (k).

The additions and the revision read as follows:

*§1.368-2 Definition of terms.*

\* \* \* \* \*

(f) \* \* \* If a transaction otherwise qualifies as a reorganization under section 368(a)(1)(B) or as a reverse triangular merger (as defined in §1.358-6(b)(2)(iii)), the target corporation (in the case of a transaction that otherwise qualifies as a reorganization under section 368(a)(1)(B)) or the surviving corporation (in the case of a transaction that otherwise qualifies as a reverse triangular merger) remains a party to the reorganization even though its stock or assets are transferred in a transaction described in paragraph (k) of this section. If a transaction otherwise qualifies as a forward triangular merger (as defined in §1.358-6(b)(2)(i)), a triangular B reorganization (as defined in §1.358-6(b)(2)(iv)), a triangular C reorganization (as defined in §1.358-6(b)(2)(ii)), or a reorganization under section 368(a)(1)(G) by reason of section 368(a)(2)(D), the acquiring corporation remains a party to the reorganization even though its stock is transferred in a transaction described in paragraph (k) of this section. The two preceding sentences apply to transactions occurring after the date these regulations are published as final regulations in the **Federal Register**.

\* \* \* \* \*

(k) *Certain transfers of assets or stock in reorganizations—(1) General rule.* A transaction otherwise qualifying as a reorganization under section 368(a) shall not be disqualified as a result of the transfer or successive transfers to one or more corporations controlled in each transfer by the transferor corporation of part or all of—

(i) The assets of any party to the reorganization; or

(ii) The stock of any party to the reorganization other than the issuing corporation (as defined in §1.368-1(b)).

(2) *Control.* Control is defined under section 368(c).

(3) *Examples.* The following examples illustrate the application of this paragraph (k). P is the issuing corporation and T is

the target corporation. P has only one class of stock outstanding. The examples are as follows:

*Example 1. Transfers of acquired assets to controlled corporations after a reorganization under section 368(a)(1)(C).* (i) *Facts.* T operates a bakery that supplies delectable pastries and cookies to local retail stores. The acquiring corporate group produces a variety of baked goods for nationwide distribution. P owns 80 percent of the stock of S-1. Pursuant to a plan of reorganization, T transfers all of its assets to S-1 solely in exchange for P stock, which T distributes to its shareholders. S-1 owns 80 percent of the stock of S-2, and S-2 owns 80 percent of the stock of S-3, which also makes and supplies pastries and cookies. Pursuant to the plan of reorganization, S-1 transfers all of the T assets to S-2, and S-2 transfers all of the T assets to S-3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(C), is not disqualified by reason of the fact of the successive transfers of all of the T assets to S-2, and from S-2 to S-3 because, in each transfer, the transferee corporation is controlled by the transferor corporation.

*Example 2. Transfers of acquired assets to controlled corporations after a reorganization under section 368(a)(1)(D).* (i) *Facts.* The facts are the same as *Example 1* except that P also owns 100 percent of the stock of T before the transaction, and T transfers all of its assets to S-1 solely in exchange for S-1 stock, which T distributes to P.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(D), is not disqualified by reason of the fact of the successive transfers of all of the acquired assets from S-1 to S-2, and from S-2 to S-3 because, in each transfer, the transferee corporation is controlled by the transferor corporation.

*Example 3. Transfer of acquiring stock to controlled corporation after a reorganization under section 368(a)(1)(A).* (i) *Facts.* The facts are the same as *Example 1* except that P owns 80 percent of the stock of S-4 and, pursuant to the plan of reorganization, S-1 acquires all of the T assets as a result of the merger of T with and into S-1. In addition, in the merger, the T shareholders receive consideration 50 percent of which is stock of P and 50 percent of which is cash. Finally, pursuant to the plan of reorganization, P transfers all of the S-1 stock to S-4.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(D), is not disqualified by the transfer of all of the S-1 stock to S-4 because, in the transfer, the transferee corporation is controlled by the transferor corporation.

*Example 4. Transfers of acquired stock to controlled corporations after a reorganization under section 368(a)(1)(B).* (i) *Facts.* The facts are the same as *Example 1* except that S-1 acquires all of the T stock rather than the T assets, and as part of the plan of reorganization, S-1 transfers 50 percent of the T stock to S-2, and S-2 transfers that T stock to S-3.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by the successive transfers of part of the acquired stock from

S-1 to S-2, and from S-2 to S-3 because, in each transfer, the transferee corporation is controlled by the transferor corporation.

*Example 5. Transfers of acquiring corporation stock to controlled corporations after a reorganization under section 368(a)(1)(B).* (i) *Facts.* The facts are the same as *Example 4* except that P owns 80 percent of the stock of S-4, and S-4 owns 80 percent of the stock of S-5, and, as part of the plan of reorganization, following the acquisition of T stock by S-1, P transfers 10 percent of its S-1 stock to S-4, and S-4 transfers that S-1 stock to S-5.

(ii) *Analysis.* Under this paragraph (k), the transaction, which otherwise qualifies as a reorganization under section 368(a)(1)(B), is not disqualified by reason of the successive transfers of S-1 stock to S-4, and from S-4 to S-5 because, in each transfer, the transferee corporation is controlled by the transferor corporation.

*Example 6. Transfer of acquired stock to a partnership.* (i) *Facts.* The facts are the same as in *Example 4*. However, as part of the plan of reorganization, S-2 and S-3 form a new partnership, PRS. Immediately thereafter, S-3 transfers all of its T stock to PRS in exchange for an 80 percent partnership interest, and S-2 transfers cash to PRS in exchange for a 20 percent partnership interest.

(ii) *Analysis.* This paragraph (k) describes the successive transfers of T stock to S-3, but does not describe S-3's transfer of T stock to PRS. Therefore, the characterization of this transaction must be determined under the relevant provisions of law, including the step transaction doctrine. See §1.368-1(a). The transaction fails to meet the control requirement of a reorganization described in section 368(a)(1)(B) because immediately after the acquisition of the T stock, the acquiring corporation does not have control of T.

(4) *Effective date.* This paragraph (k) applies to transactions occurring after the date these regulations are published as final regulations in the **Federal Register**.

Mark E. Matthews,  
Deputy Commissioner for Services  
and Enforcement.

(Filed by the Office of the Federal Register on March 1, 2004, 8:45 a.m., and published in the issue of the Federal Register for March 2, 2004, 69 F.R. 9771)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Notional Principal Contracts; Contingent Nonperiodic Payments

REG-166012-02

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 inclusion into income or deduction of a contingent nonperiodic payment provided for under a notional principal contract (NPC). This document also provides guidance relating to the character of payments made pursuant to an NPC. These regulations will affect taxpayers that enter into NPCs. This document also provides a notice of a public hearing on these proposed regulations.

**DATES:** Written or electronically transmitted comments and requests to speak (with outlines of oral comments to be discussed) at the public hearing scheduled for May 25, 2004, at 10 a.m., must be received by May 4, 2004. Comments on the collection of information should be received by April 26, 2004.

**ADDRESSES:** Send submissions to CC:PA:LPD:PR (REG-166012-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-166012-02), Couriers Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit electronic comments directly to the IRS Internet site at: [www.irs.gov/regs](http://www.irs.gov/regs). The public hearing will be held in the IRS Auditorium, Seventh Floor, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

**FOR FURTHER INFORMATION CONTACT:** Concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Sonya Cruse, (202) 622-7180; concerning the regulations, Kate Sleeth, (202) 622-3920 (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 the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by April 26, 2004. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the IRS, 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 services to provide information.

The collection of information in these proposed regulations is in §1.446-3(g)(6)(vii). This information is required by the IRS to verify compliance with section 446 and the method of accounting described in §1.446-3(g)(6). This information will be used to determine whether the amount of tax has been calculated correctly. The collection of information is required to properly determine the amount of income or deduction to be taken into account. The respondents are sophisticated investors that enter into notional principal contracts with contingent nonperiodic payments.

Estimated total annual recordkeeping burden: 25,500 hours.

Estimated average annual burden per recordkeeper: 6 hours.

Estimated number of recordkeepers: 4,250.

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

## Background

This document contains proposed amendments to 26 CFR Part 1 under section 446(b) of the Internal Revenue Code (Code). This document also contains proposed amendments under sections 162, 212 and 1234A of the Code.

In 1989, the IRS issued Notice 89-21, 1989-1 C.B. 651, to provide guidance with respect to the tax treatment of lump-sum payments received in connection with NPCs. The notice stated that a method of accounting that properly recognizes a lump-sum payment over the life of the contract clearly reflects income and indicated that regulations would be issued to provide specific rules regarding the manner in which a taxpayer must take into account over the life of an NPC payments made or received with respect to the contract. The notice further stated that “for contracts entered into prior to the effective date of the regulations, the Commissioner will generally treat a method of accounting as clearly reflecting income if it takes such payments into account over the life of the contract under a reasonable amortization method, whether or not the method satisfies the specific rules in the forthcoming regulations.” (1989-1 C.B. 652).

On October 14, 1993, the IRS published in the **Federal Register** final regulations (T.D. 8491, 1993-2 C.B. 215 [58 FR 53125]) under section 446(b) relating to the timing of income and deductions for amounts paid or received pursuant to NPCs. §1.446-3. In this preamble, the final regulations published in 1993 are referred to as the 1993 Treasury regulations.

The 1993 Treasury regulations define an NPC as a “financial instrument that provides for the payment of amounts by one party to another at specified intervals calculated by reference to a specified index upon a notional principal amount in exchange for specified consideration or a promise to pay similar amounts.”

§1.446-3(c)(1)(i). Payments made pursuant to NPCs are divided into three categories (periodic, nonperiodic, and termination payments), and the 1993 Treasury regulations provide timing regimes for each. The 1993 Treasury regulations require all taxpayers, regardless of their method of accounting, to recognize the ratable daily portion of a nonperiodic payment for the taxable year to which that portion relates. Nonperiodic payments generally must be recognized over the term of an NPC in a manner that reflects the economic substance of the contract. §1.446-3(f)(2)(i). Although §1.446-3 does not distinguish between noncontingent and contingent nonperiodic payments, the specific rules and examples in the 1993 Treasury regulations address only noncontingent nonperiodic payments. The Preamble to the 1993 Treasury regulations states that “the IRS expects to address contingent payments in future regulations, and welcomes comment on the treatment of those payments.” (1993-2 C.B. 216). In addition, neither §1.446-3 nor any other section provides specific rules governing the character of the various types of NPC payments.

On July 23, 2001, the IRS published Notice 2001-44, 2001-2 C.B. 77, soliciting comments on the appropriate method for the inclusion or deduction of contingent nonperiodic payments made pursuant to NPCs and the proper character treatment of payments made pursuant to an NPC. The notice set forth four different methods under consideration by the IRS and Treasury and asked the public to comment on the extent to which each method reflects certain fundamental tax policy principles, including certainty, clarity, administrability, and neutrality. Several comments were received from the public, which expressed diverse views regarding the relative advantages and disadvantages of the different methods. Included in the four methods were the noncontingent swap method and a mark-to-market method, versions of which are adopted in the proposed regulations.

The notice also solicited comments on the proper character of payments on NPCs and bullet swaps. The comments received on this issue also reflected differing views.

## Explanation of Provisions

### A. Overview

The IRS and Treasury understand that some taxpayers take into account contingent nonperiodic payments on an NPC only when the payment becomes fixed and determinable (the open transaction or wait-and-see method of accounting). The wait-and-see method, however, is inconsistent with the existing specific timing rules for periodic and nonperiodic payments and with the general rule in §1.446-3(f)(2)(i) respecting recognition of nonperiodic payments over the term of the contract. For example, if the amount of a periodic payment is set in arrears at the end of an accrual period that spans taxable years, the parties cannot use a wait-and-see method for the portion of the accrual period in the first taxable year. Instead, the parties must use a reasonable estimate of the payment for determining taxable income in the year before the payment is fixed. §1.446-3(e)(2)(ii). In addition, some NPCs are structured to provide for nonperiodic payments consisting of a noncontingent component and a contingent component, which the parties to the contract treat as a single contingent payment that they account for under the wait-and-see method. The attempted application of the wait-and-see method to these contracts highlights the potential for abuse present in the method. See Rev. Rul. 2002-30, 2002-1 C.B. 971.

The back-loaded timing of tax consequences that results from the wait-and-see method is also inconsistent with the timing regime that §1.1275-4(b) provides for contingent debt instruments subject to the noncontingent bond method. Under the noncontingent bond method, the parties to a contingent payment debt instrument must determine the yield at which a comparable noncontingent debt instrument would be issued and then project a fixed amount for each contingent payment and each noncontingent payment. The projected amounts are accounted for over the term of the debt instrument. The difference, if any, between the projected amount of a contingent payment and the actual amount of the payment generally is accounted for when payment is made.

The proposed regulations adopt a variation on the noncontingent swap regime

described in Notice 2001-44, as well as an elective mark-to-market regime. The 1993 Treasury regulations reflect an underlying principle that nonperiodic payments should be spread over the term of an NPC in a manner that properly reflects the economic substance of the contract. The proposed regulations build upon this principle. Furthermore, the IRS and Treasury believe that the proposed regulations provide a timing regime for contingent nonperiodic payments that clearly reflects the economics of the underlying contracts. The requirement that nonperiodic payments be spread over the term of an NPC results in substantially similar treatment for all NPCs without regard to whether payment obligations are settled on a current basis through periodic payments or are either pre-paid or deferred through nonperiodic payments. Adopting this approach for contingent payment NPCs achieves symmetry between fixed payment NPCs and contingent payment NPCs.

The proposed noncontingent swap method requires taxpayers to project the expected amount of contingent payments, to take into account annually the appropriate portions of the projected contingent amounts, to reproject the contingent amounts annually, and to reflect the differences between projected amounts and reprojected amounts through adjustments. The IRS and Treasury recognize that annual rejections will require additional effort by taxpayers and the IRS. The IRS and Treasury believe, however, that the annual rejection requirement is essential to ensure clear reflection of income with respect to NPCs with one or more contingent nonperiodic payments. Moreover, rejections, and the resulting adjustments to current inclusion and deduction amounts, are especially important for the income and deductions generated by these types of contracts because otherwise, taxpayers might be more likely to attempt to manipulate the character of the income or deductions from the contract.

In developing the proposed regulations, the IRS and Treasury have taken into account comments received in response to Notice 2001-44, as well as the following considerations. First, although many comments advocated the wait-and-see method of accounting for contingent nonperiodic payments, this method encourages the creation of NPCs that provide such payments.

As a result of the adoption of guidelines for taking contingent nonperiodic payments into account over the term of an NPC, the tax treatment of payments with respect to an NPC should no longer provide an incentive for structuring payments in a particular manner. Second, taxpayers using swaps with contingent nonperiodic payments are sophisticated investors. Many of these taxpayers will be making similar projections and rejections for their own purposes in evaluating the results of their derivative investments and taking actions to manage the risks created by their derivative investments. Third, the proposed regulations also provide an elective mark-to-market method as an alternative to the noncontingent swap method. Taxpayers who use a mark-to-market method for financial reporting purposes may adopt the elective mark-to-market method to reduce their tax and accounting administrative burden for NPCs.

The IRS and Treasury understand that similar timing issues exist for other types of derivative investments, like bullet swaps and prepaid forward contracts. Although the application of the proposed regulations to these types of transactions may achieve appropriate timing, the application of these rules to investments other than NPCs could present a number of issues not directly addressed by the rules contained in these proposed regulations. The expansion of the scope of these proposed regulations to contracts other than NPCs is not being proposed at this time so as not to delay the publication of the proposed regulations.

With respect to character, the proposed regulations under sections 162 and 212 provide that both periodic and nonperiodic payments with respect to NPCs are generally ordinary in character. This is because neither periodic nor nonperiodic payments (whenever made) involve a sale or exchange within the meaning of section 1222, and no other section of the Code provides otherwise. The proposed regulations issued under section 1234A provide capital treatment for termination payments. Under the proposed regulations, however, even nonperiodic payments made at the maturity of an NPC are not termination payments under section 1234A.

Because of their recurring nature, periodic payments should be treated as ordinary income items, whether or not the

payments are made at the expiration of an NPC. The same rationale applies to nonperiodic payments, which are required to be spread over the term of an NPC. Even if a nonperiodic payment is made at the expiration or termination of an NPC, only the final portion is taken into account on the termination date for the contract, and that portion should be treated in the same way as a periodic payment.

## *B. Specific Provisions*

### *Adjustments*

Paragraph (d)(2) of the proposed regulations provides for adjustments to be made in the gain or loss realized on the sale, exchange, or termination of an NPC, to account for inclusions into income and deductions provided for in the 1993 Treasury regulations and the proposed regulations, as well as for any payments made or received on the NPC. These adjustments are expected to produce consequences similar to the consequences that would result if basis were increased or decreased for these items. Using adjustments for this purpose avoids the issue of negative basis.

### *Significant nonperiodic payments*

Paragraph (g)(4) of the proposed regulations clarifies the rules for the treatment of an NPC with a significant upfront nonperiodic payment and provides additional rules for the treatment of a significant nonperiodic payment that is not paid upfront. The 1993 Treasury regulations provide that a significant nonperiodic payment on an NPC is treated as two separate transactions — an on-market level payment NPC and a loan. §1.446-3(g)(4). The proposed regulations clarify that the parties to an NPC with one or more significant nonperiodic payments must treat the contract as two or more separate transactions consisting of an on-market NPC and one or more loans. In some cases, the on-market NPC payments for a party making a significant nonperiodic upfront payment will be level payments that may be constructed through a combination of the actual payments on the NPC and level payments computed under the level payment method described in §1.446-3(f)(2)(iii)(A).

The proposed regulations also provide that an NPC with a significant nonperiodic payment that is not paid upfront is

treated as if the party receiving the significant nonperiodic payment paid a series of annual level payment loan advances, equal to the present value of the nonperiodic payment, to the party owing the significant nonperiodic payment. The interest component of the level payments is treated as interest for all purposes of the Code and is not taken into account in determining the income and deductions on the NPC. The principal component of the level payments is calculated solely to determine the interest amount. The party owing the significant nonperiodic payment is then treated as using the level payment loan advances to make annual level payment NPC payments, which are included in income and deducted as provided in §1.446-3(d).

### *Contingent nonperiodic payments*

The 1993 Treasury regulations define both periodic and nonperiodic payments but do not distinguish between contingent and noncontingent nonperiodic payments. Paragraph (g)(6)(i)(B) of the proposed regulations defines a contingent nonperiodic payment as any nonperiodic payment other than a noncontingent nonperiodic payment. A noncontingent nonperiodic payment is defined in paragraph (g)(6)(i)(A) of the proposed regulations as a nonperiodic payment that either is fixed on or before the end of the taxable year in which a contract commences or is equal to the sum of amounts that would be periodic payments if they are paid when they become fixed, including amounts determined as interest accruals.

Paragraph (g)(6)(ii) of the proposed regulations sets forth the noncontingent swap method for the inclusion into income and deduction of contingent nonperiodic payments. The noncontingent swap method requires taxpayers to project the reasonably expected amount of the contingent nonperiodic payment and to apply the level payment method and, as appropriate, the rules for significant nonperiodic payments, to the projected amount as if it were a noncontingent nonperiodic payment. The risk-free rate of return, which is defined in the proposed regulations, is used in applying the level payment method.

Paragraphs (g)(6)(iii)(A) through (C) of the proposed regulations provide the methods for projecting the reasonably expected

amount. If the contingent payment is determined by reference to the value of a specified index at a designated future date, the projected amount may be determined by reference to the future value of the specified index in actively traded futures or forward contracts providing for delivery or settlement on the designated future date. If no actively traded contract exists for the designated future date, the value may be derived from actively traded futures or forward contracts providing for delivery or settlement within three months of the designated future date.

The projected amount may also be determined based on the projected future value of the current market price of the specified index. The future value is determined using a constant yield method at the risk-free interest rate with appropriate compounding and making appropriate adjustments for expected cash payments on the property underlying the specified index. The proposed regulations use the applicable federal rate under section 1274(d)(1) as the risk-free rate for this purpose. Comments are requested on whether this rate is appropriate.

If neither of the two methods described above results in a reasonable estimate of the future value of the specified index, the taxpayer must use another method that does result in a reasonable estimate of the amount of the contingent payment and that is based on objective financial information, and must consistently use the method from year to year.

The proposed regulations require annual adjustments to the projected amounts of the contingent payment. Paragraphs (g)(6)(iv) through (vi) of the proposed regulations provide rules for the redetermination of the projected amount of the contingent payment and the subsequent adjustments to the recognition of income and deductions under a contract based on the reprojected amount.

Paragraph (g)(6)(iv) of the proposed regulations provides that the projected amount must be redetermined on each successive anniversary date (redetermination date) and on each special redetermination date as described below. On each redetermination date, the taxpayer must reproject the amount of the contingent payment using the same method used at the commencement of the NPC but applied to the new current value of the specified

index. Once the contingent payment is reprojected, the level payment method (and the rules for significant nonperiodic payments, if applicable) are applied again using the new projected amount.

Comments are requested as to how the reprojection process should respond to changes in the availability of market data during the life of an NPC. Suppose, for example, that the initial projection is made when there are no actively traded futures or forward contracts in the specified index but that these contracts come into existence before the time of one of the rejections. Should the rejections be made using the newly available futures data rather than the method employed for the first projection?

Paragraph (g)(6)(v) of the proposed regulations provides rules for adjustments following the redetermination of the projected amount of the contingent payment. The amounts determined for the redetermined projected amount under the level payment method and, as applicable, the rules for significant nonperiodic payments, are recognized in the current and subsequent taxable years. In addition, any difference between the newly determined amounts for prior periods and the amounts determined and previously taken into account using the previously projected contingent payment are recognized ratably over the one-year period beginning with the redetermination date. Any difference in amounts that would have been treated as interest under the rules for significant nonperiodic payments is also treated as interest for all purposes of the Code.

Paragraph (g)(6)(iv)(B) of the proposed regulations provides a special rule for a contingent nonperiodic payment that is fixed more than six months before it is due. If the date on which the payment becomes fixed is in a different taxable year from the date it is due, the date on which the payment becomes fixed is a special redetermination date. In such a case, the fixed amount is treated as the reprojected amount, and the rules described above for redeterminations and adjustments apply.

In general, under paragraph (g)(6)(vi) of the proposed regulations, when a contingent payment is made, the parties must make appropriate adjustments to the amount of income or deduction attributable to the NPC for any differences between the projected amount of the con-

tingent payment and the actual amount of the contingent payment.

Paragraph (g)(6)(vii) of the proposed regulations provides a recordkeeping requirement with respect to the noncontingent swap method. Taxpayers must maintain in their books and records a description of the method used to determine the projected amount of the contingent payment, the projected payment schedules, and the adjustments taken into account under the proposed regulations.

The IRS and Treasury are considering whether to provide an alternative to the noncontingent swap method that would permit a taxpayer to use a current inclusion method for certain NPCs that provide for periodic calculations of amounts due under the terms of the NPC, but provide for deferred payment of the amounts. The IRS and Treasury are considering permitting current inclusion of income and deduction for the amounts so calculated, provided the NPC also provides for accrual of interest at a qualified rate until the periodically determined amounts are paid or offset against other amounts due under the NPC. The purpose of providing a current inclusion method for the deferred payment NPC described above is to provide tax treatment for NPCs with contingent nonperiodic payments that is economically equivalent to the tax treatment of NPCs providing only for periodic payments while avoiding the necessity of using projected amounts for contingent payments. The IRS and Treasury request comments concerning whether an NPC like the deferred payment NPC described above would be a viable transaction for market participants, whether a current inclusion method would be an appropriate substitute for the noncontingent swap method for deferred payment NPCs, and whether that method should require separate computation of interest accruals.

#### *Elective mark-to-market methodology*

Paragraph (i) of the proposed regulations provides an elective mark-to-market methodology for certain NPCs providing for nonperiodic payments. If an election is made, the specific accounting rules for nonperiodic payments in §1.446-3(f)(2) (other than (f)(2)(i)) are not applicable. Instead, for any contract that is held at the close of the taxable year, the taxpayer

determines income inclusions and deductions by reference to the gain or loss that would be realized if the contract were sold for its fair market value on the last business day of the taxable year. Because the determination of fair market value takes into account the expected value of future nonperiodic payments, the mark-to-market methodology constitutes a reasonable basis for amortizing the nonperiodic payments over the term of the contract as required by §1.446-3(f)(2)(i).

Proper adjustments are made in the amount of gain or loss subsequently realized (or calculated) for income inclusions and deductions taken into account in marking the contract to fair market value. Furthermore, under paragraph (i)(5) of the proposed regulations, if an election is made for a contract providing for a significant nonperiodic payment, paragraph (g)(4) continues to apply and proper adjustments must be made to the income inclusions and deductions recognized under the mark-to-market methodology to take into account amounts recognized as interest and the payment or receipt of the significant nonperiodic payment, subject to the special rule set forth below.

The proposed regulations set forth a special rule for contracts providing for significant contingent nonperiodic payments that are subject to the mark-to-market election. If a contract provides for a significant contingent nonperiodic payment, the taxpayer must apply the noncontingent swap method to determine the amounts recognized as interest under paragraph (g)(4). However, the taxpayer is not required to reproject the amount of the contingent payment each year. The interest amounts for subsequent years are the interest amounts as determined using the initial projection of the contingent payment. Furthermore, an alternative deemed equivalent value method may be used to determine the projected amount of the contingent payment. The deemed equivalent value method may be applied when the contract fixes the timing and amount of all of the payments under the contract, except for the significant contingent nonperiodic payment. The amount of the significant contingent nonperiodic payment is deemed to be the amount that causes the present value of all the payments by the taxpayer to equal the present value of all of the payments of the counterparty to the contract.

The inclusion of an elective mark-to-market methodology is intended to provide taxpayers with an alternative to the provisions of paragraphs (f) of the 1993 Treasury regulations and (g)(6) of the proposed regulations respecting nonperiodic payments. With respect to significant nonperiodic payments, however, the proposed regulations preserve certain features of those provisions for purposes of computing an interest component of swap payments. Such a calculation is necessary to preserve the characterization of an accrual as interest. The IRS and Treasury request comments on the appropriateness of requiring taxpayers to compute an interest amount for significant nonperiodic payments under the elective mark-to-market methodology and, in particular, on any effect that requirement may have on the relative usefulness and administrability of the mark-to-market methodology.

Paragraph (i)(2) of the proposed regulations provides the scope of the election. The election is available to contracts that are: (1) actively traded within the meaning of §1.1092(d)-1(c) (determined without regard to the limitation in §1.1092(d)-1(c)(2)); (2) marked to market for purposes of the taxpayer's financial statements provided the taxpayer satisfies the requirements in paragraph (i)(4) of the proposed regulations; (3) subject to an agreement by a party to the contract that is a person to whom section 475 applies to supply to the taxpayer the value that it uses in applying section 475(a)(2); or (4) marked to market by a regulated investment company (RIC) described in section 1296(e)(2). Paragraphs (i)(3)(i) through (iv) of the proposed regulations provide the acceptable methods for determining fair market value. If the contract is actively traded, the fair market value is determined based on the mean between the bid and asked prices quoted for the contract. If a contract is not actively traded, but is marked to market for financial statement purposes, and the valuations used for those purposes comply with the requirements of paragraph (i)(4), the fair market value is deemed to be the value used for the financial statements. For a contract that is subject to an agreement with a dealer in securities to provide a value, the value that is provided by the dealer is the fair market value. Finally, for a contract marked to market by a RIC, the fair market value

is equal to the value used for purposes of determining the RIC's net asset value.

Paragraph (i)(6) of the proposed regulations provides that the mark-to-market election shall be made in the time and manner prescribed by the Commissioner and is effective for the taxable year in which it is made and all subsequent years unless revoked with the consent of the Commissioner.

The proposed regulations indicate that a taxpayer will be permitted to elect the mark-to-market method for NPCs that are marked to market for purposes of the taxpayer's financial statements and that the values used on the financial statements may be used as fair market value under the mark-to-market election. However, the proposed regulations also indicate that an election to use financial statement values will be subject to further requirements. On May 5, 2003, the IRS and Treasury published in the **Federal Register** an Advance Notice of Proposed Rule Making (REG-100420-03, published in the I.R.B. as Announcement 2003-35, 2003-21 I.R.B. 956) requesting comments regarding appropriate rules for the use of financial statement values under the mark-to-market provisions of section 475 applicable to securities dealers and electing commodities dealers and securities and commodities traders. The IRS and Treasury will take into account the comments received in response to that Advance Notice in developing the rules to be established for use of financial statement values under the mark-to-market method set forth in paragraph (i) of the proposed regulations. In addition, unlike other mark-to-market regimes, the mark-to-market method proposed in paragraph (i) does not require a mark immediately before disposition in either a recognition or non-recognition context. Cf. section 1256(c) and proposed regulations §1.475(a)-2. The IRS and Treasury request comments regarding this aspect of the proposed regulations and whether taxpayers who are eligible to elect a mark-to-market method under section 475 but do not do so should be eligible to make the paragraph (i) election for NPCs.

#### *Anti-abuse rule*

Paragraph (i) of the 1993 Treasury regulations provides that if a taxpayer "en-

ters into a transaction with a principal purpose of applying the rules of [§1.446-3] to produce a material distortion of income," the IRS may depart from those rules "as necessary to reflect the appropriate timing of income and deductions from the transaction." In light of the comprehensive rules in the proposed regulations prescribing methods of accounting for NPCs, the IRS and Treasury have determined that a general anti-abuse rule is not necessary to prevent these methods being used in a manner that fails to clearly reflect income. Accordingly, the proposed regulations delete this rule.

#### *Proposed dates of applicability*

These proposed regulations contain both new substantive rules as well as clarifying changes to the 1993 Treasury regulations. The new substantive rules, which are contained in paragraph (g)(6) (the noncontingent swap method) (except (g)(6)(i)) and paragraph (i) (the mark-to-market election), are proposed to apply to NPCs entered into on or after 30 days after the date of publication of the final regulations in the **Federal Register**. Paragraphs (c) (definitions), (d) (taxable year of inclusion and deduction), (f) (nonperiodic payments), (g)(4) (significant nonperiodic payments), and (g)(6)(i) (definition of contingent and noncontingent nonperiodic payments) are proposed to be integrated into the 1993 Treasury regulations which apply to NPCs entered into on or after December 13, 1993. Because of their purely clarifying nature, these proposed changes will apply to the same transactions that are governed by the 1993 Treasury regulations.

With respect to NPCs that provide for contingent nonperiodic payments and that are in effect or entered into on or after 30 days after the date of publication of these proposed regulations in the **Federal Register**, if a taxpayer has not adopted a method of accounting for these NPCs, the taxpayer must adopt a method that takes contingent nonperiodic payments into account over the life of the contract under a reasonable amortization method, which may be, but need not be, a method that satisfies the specific rules in these proposed regulations. If a taxpayer has adopted a method of accounting for these NPCs, the Commissioner generally will not require

a change in the accounting method earlier than the first year ending on or after 30 days after the date of publication of the final regulations in the **Federal Register**. The preceding sentence does not apply to transactions described in Rev. Rul. 2002-30, 2002-1 C.B. 971, or other published guidance.

The proposed regulations do not contain a specific consistency requirement. Nevertheless, under the general rules governing accounting methods, once a taxpayer adopts a method of accounting for an item, the taxpayer must use the same method from year to year unless the taxpayer obtains the Commissioner's consent to change to another method of accounting.

#### *Character*

The proposed regulations under §1.162-30 provide that in general, the net periodic and nonperiodic payments (including mark-to-market deductions) are deductible by the payor under section 162 as ordinary and necessary business expenses. However, payments representing interest under the rules for significant nonperiodic payments as well as termination payments are not deductible under section 162. A similar rule is provided for individuals in the proposed regulations under §1.212-1(q). These regulations under sections 162 and 212 are proposed to apply to NPCs entered into on or after 30 days after the date of publication of the final regulations in the **Federal Register**.

Any gain or loss arising from a termination payment, however, is treated as capital gain or loss pursuant to the proposed regulations under section 1234A. These proposed regulations clarify that periodic payments, noncontingent nonperiodic payments, and contingent nonperiodic payments are not termination payments.

The proposed regulations under section 1234A also apply to any gain or loss arising from the settlement of obligations under a bullet swap or forward contract. A payment in settlement of obligations under a bullet swap or forward contract, including a payment pursuant to the terms of the bullet swap or forward contract, is treated as gain or loss from a termination of the bullet swap or forward contract.

For purposes of these proposed regulations, a bullet swap is defined as a financial

instrument that is not an excluded contract as defined in §1.446-3(c)(1)(ii), that provides for the computation of an amount or amounts due from one party to another by reference to a specified index upon a notional principal amount, and that provides for settlement of all the parties' obligations at or close to maturity of the contract, rather than for the payment of the specified amounts at specific intervals. The definition of bullet swap is intended to cover a contract that obligates each party to make a payment at the end of the contract, although only one net payment will actually be paid. For example, party A is obligated to pay at the end of three years a fixed rate multiplied by the notional amount. Also at the end of three years, party B is obligated to pay a variable rate multiplied by the same notional amount. At the end of three years, only one party makes a net payment equal to the difference between the fixed rate multiplied by the notional amount and the variable rate multiplied by the notional amount.

These regulations under section 1234A are proposed to apply to NPCs entered into on or after 30 days after the date of publication of the 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 is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that very few small businesses enter into NPCs with contingent nonperiodic payments because these contracts are costly and complex and because they require constant monitoring and a sophisticated understanding of the capital markets. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the 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 businesses.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS and Treasury specifically 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 May 25, 2004, 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 Constitution Avenue entrance. 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 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see "FOR FURTHER INFORMATION CONTACT" section of this 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 or electronic comments and an outline of topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by May 4, 2004. 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 Kate Sleeth, Office of the Associate Chief Counsel (Financial Institutions and Products). However, other personnel from the IRS and Treasury participated in their development.

\* \* \* \* \*

### 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 continues to read in part as follows:

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

Par. 2. Section 1.162-30 is added to read as follows:

#### *§1.162-30 Notional principal contract payments.*

(a) *In general.* Amounts taken into account by a taxpayer pursuant to §1.446-3(d)(1) (including mark-to-market deductions) with respect to a notional principal contract as defined in §1.446-3(c)(1)(i), are deductible as ordinary and necessary business expenses. However, this section will not apply to any amount representing interest expense on the deemed loan component of a significant nonperiodic payment as described in §1.446-3(g)(4). For any loss arising from a termination payment as defined in §1.446-3(h)(1), see section 1234A and the regulations thereunder. For the timing of deductions with respect to notional principal contracts, see §1.446-3.

(b) *Effective date.* Paragraph (a) of this section is applicable to notional principal contracts entered into on or after 30 days after the date a Treasury decision based on these proposed regulations is published in the **Federal Register**.

Par. 3. In §1.212-1, paragraph (q) is added to read as follows:

#### *§1.212-1 Nontrade or nonbusiness expenses.*

\* \* \* \* \*

(q) *Notional principal contract payments*—(1) Amounts taken into account by an individual pursuant to §1.446-3(d)(1) (including mark-to-market deductions) with respect to a notional principal contract as defined in §1.446-3(c)(1)(i), are ordinary and necessary, and are deductible to the extent these amounts are paid or incurred in connection with the production or collection of income. However, this section will not apply to any amount representing interest expense on

the deemed loan component of a significant nonperiodic payment as described in §1.446-3(g)(4). For any loss arising from a termination payment as defined in §1.446-3(h)(1), see section 1234A and the regulations thereunder. For the timing of deductions with respect to notional principal contracts, see §1.446-3.

(2) *Effective date.* Paragraph (q) of this section is applicable to notional principal contracts entered into on or after 30 days after the date a Treasury decision based on these proposed regulations is published in the **Federal Register**.

Par. 4. Section 1.446-3 is amended by:

1. Revising the introductory text of paragraph (a) and the table of contents in paragraph (a).

2. Adding paragraph (c)(5).

3. Revising paragraphs (d), (f)(2)(i), (f)(2)(iii)(A), and (g)(4).

4. Redesignating the text of paragraph (g)(6) as paragraph (g)(7).

5. Adding new paragraph (g)(6).

6. Amending the newly designated text of paragraph (g)(7) by:

a. Revising the heading for *Example 3*.

b. Adding *Example 5* through *Example 9*.

7. Revising paragraphs (i) and (j).

The revisions and additions read as follows:

#### §1.446-3 Notional principal contracts.

(a) *Table of contents.* This paragraph (a) lists captioned paragraphs contained in this section.

#### §1.446-3 Notional principal contracts.

(a) Table of contents.

(b) Purpose.

(c) Definitions and scope.

(1) Notional principal contract.

(i) In general.

(ii) Excluded contracts.

(iii) Transactions within section 475.

(iv) Transactions within section 988.

(2) Specified index.

(3) Notional principal amount.

(4) Special definitions.

(i) Related person and party to the contract.

(ii) Objective financial information.

(iii) Dealer in notional principal contracts.

(5) Risk-free interest rate and determination date.

(i) Risk-free interest rate.

(ii) Determination date.

(d) Taxable year of inclusion and deduction; adjustment of gain or loss.

(1) Inclusion and deduction.

(2) Adjustment of gain or loss.

(e) Periodic payments.

(1) Definition.

(2) Recognition rules.

(i) In general.

(ii) Rate set in arrears.

(iii) Notional principal amount set in arrears.

(3) Examples.

(f) Nonperiodic payments.

(1) Definition.

(2) Recognition rules.

(i) In general.

(ii) General rule for swaps.

(iii) Alternative methods for swaps.

(A) Prepaid swaps.

(B) Other nonperiodic swap payments.

(iv) General rule for caps and floors.

(v) Alternative methods for caps and floors that hedge debt instruments.

(A) Prepaid caps and floors.

(B) Other caps and floors.

(C) Special method for collars.

(vi) Additional methods.

(3) Term of extendible or terminable contracts.

(4) Examples.

(g) Special rules.

(1) Disguised notional principal contracts.

(2) Hedged notional principal contracts.

(3) Options and forwards to enter into notional principal contracts.

(4) Swaps with significant nonperiodic payments.

(5) Caps and floors that are significantly in-the-money. [Reserved]

(6) Notional principal contracts with contingent nonperiodic payments.

(i) Definitions.

(A) Noncontingent nonperiodic payments.

(B) Contingent nonperiodic payments.

(ii) Noncontingent swap method.

(iii) Determining projected amount of contingent payment.

(A) Payment based on actively traded futures or forward contracts.

(B) Payment based on extrapolation from current market prices.

(C) Payment based on reasonable estimate.

(iv) Redeterminations of projected payments and level payment amounts.

(A) General rule.

(B) Special rule for fixed but deferred contingent nonperiodic payments.

(v) Adjustments following redeterminations.

(vi) Adjustments for differences between projected and actual payments.

(vii) Recordkeeping requirements.

(7) Examples.

(h) Termination payments.

(1) Definition.

(2) Taxable year of inclusion and deduction by original parties.

(3) Taxable year of inclusion and deduction by assignees.

(4) Special rules.

(i) Assignment of one leg of a contract.

(ii) Substance over form.

(5) Examples.

(i) Election to mark to market.

(1) General rule.

(2) Scope of election.

(3) Determination of fair market value.

(i) Determination based on readily ascertainable value.

(ii) Determination based on value used for financial statements.

(iii) Determination based on counterparty's mark-to-market value.

(iv) Determination based on value used in determining net asset value.

(4) Requirements for use of financial statement values. [Reserved]

(5) Notional principal contracts accruing interest on significant nonperiodic payments.

(i) General rule.

(ii) Special rules for significant contingent nonperiodic payments.

(iii) Nonapplicability to regulated investment companies.

(6) Election.

(j) Effective dates.

(1) General rule.

(2) Exception.

\* \* \* \* \*

(c) \* \* \*

(5) *Risk-free interest rate and determination date*—(i) *Risk-free interest rate.* The risk-free interest rate is the applicable Federal rate determined in accordance with section 1274(d)(1) for a determination date and the period remaining in the term of the contract on the determination date.

(ii) *Determination date.* A determination date is the commencement date of the swap, each redetermination date as defined in paragraph (g)(6)(ii) of this section, and each special redetermination date as defined in paragraph (g)(6)(iv)(B) of this section.

(d) *Taxable year of inclusion and deduction; adjustment of gain or loss—(1) Inclusion and deduction.* For all purposes of the Internal Revenue Code, the net income or net deduction from a notional principal contract for a taxable year is taken into account for that taxable year. The net income or net deduction from a notional principal contract for a taxable year equals the total of all of the periodic payments that are recognized from that contract for the taxable year under paragraph (e) of this section, all of the nonperiodic payments that are recognized from that contract for the taxable year under paragraph (f) of this section, and the mark-to-market income inclusions and deductions recognized from that contract under paragraph (i) of this section.

(2) *Adjustment of gain or loss.* Proper adjustment shall be made in the amount of any gain or loss realized on a sale, exchange, or termination of a notional principal contract for inclusions or deductions pursuant to paragraphs (d)(1) and (g)(4) of this section and for payments or receipts with respect to the notional principal contract.

\* \* \* \* \*

(f) \* \* \*

(2) *Recognition rules—(i) In general.* All taxpayers, regardless of their method of accounting, must recognize the ratable daily portion of a nonperiodic payment for the taxable year to which that portion relates. Generally, a nonperiodic payment must be recognized over the term of a notional principal contract in a manner that reflects the economic substance of the contract. See paragraph (g)(6) of this section for additional rules for contingent nonperiodic payments.

\* \* \* \* \*

(iii) \* \* \*

(A) *Prepaid swaps.* An upfront payment on a swap may be amortized by assuming that the nonperiodic payment represents the present value of a series of equal payments made throughout the term of the swap contract (the level payment

method), adjusted as appropriate to take account of increases or decreases in the notional principal amount. The discount rate used in this calculation must be the rate (or rates) used by the parties to determine the amount of the nonperiodic payment. If that rate is not readily ascertainable, the discount rate used must be a rate that is reasonable under the circumstances. Under this method, an upfront payment is allocated by dividing each equal payment into its principal recovery and time value components. The principal recovery components of the equal payments are treated as periodic payments that are deemed to be made on each of the dates that the swap contract provides for periodic payments by the payor of the nonperiodic payment or, if none, on each of the dates that the swap contract provides for periodic payments by the recipient of the nonperiodic payment. The sum of the principal recovery components equals the amount of the upfront payment. The time value component is used to compute the amortization of the nonperiodic payment but is otherwise disregarded. See paragraph (f)(4) *Example 5* of this section.

\* \* \* \* \*

(g) \* \* \*

(4) *Swaps with significant nonperiodic payments.* The parties to a swap with one or more significant nonperiodic payments must treat the contract as two or more separate transactions consisting of an on-market swap and one or more loans. The parties must account for the loans separately from the swap. The payments associated with the on-market swap are included in the net income or net deduction from the swap under paragraph (d) of this section. The time value components associated with the loans are not included in the net income or net deduction from the swap under paragraph (d) of this section but are recognized as interest for all purposes of the Internal Revenue Code. The on-market swap must result in recognition of the payments associated with the swap in a manner that complies with the principles set forth in paragraph (f)(2)(i) of this section. See paragraph (g)(7) *Example 3* of this section for a situation in which the on-market swap payments for a party making a significant nonperiodic upfront payment will be level payments that may be constructed through a combi-

nation of the actual payments on the swap and level payments computed under the level payment method provided by paragraph (f)(2)(iii)(A) of this section. In certain cases, a swap with significant nonperiodic payments other than an upfront payment may be treated as if the swap provided for a series of level payment loan advances having a present value equal to the present value of the nonperiodic payments, with the amount of each loan advance being immediately returned as a level payment on the swap. See paragraph (g)(7) *Example 5* of this section. For purposes of section 956, the Commissioner may treat any nonperiodic swap payment, whether or not it is significant, as one or more loans.

\* \* \* \* \*

(6) *Notional principal contracts with contingent nonperiodic payments—(i) Definitions—(A) Noncontingent nonperiodic payments.* A noncontingent nonperiodic payment is a nonperiodic payment that either is fixed on or before the end of the taxable year in which a contract commences or is equal to the sum of amounts that would be periodic payments if they are paid when they become fixed (including amounts determined as interest accruals).

(B) *Contingent nonperiodic payments.* A contingent nonperiodic payment is any nonperiodic payment other than a noncontingent nonperiodic payment.

(ii) *Noncontingent swap method.* Under the noncontingent swap method, a taxpayer, regardless of its method of accounting, recognizes each contingent nonperiodic payment with respect to a notional principal contract by determining the projected amount of the payment and by applying to that projected amount the level payment method described in paragraphs (f)(2)(iii)(A) and (B) of this section. The projected amount of a contingent nonperiodic payment is the reasonably expected amount of the payment, which is determined by using one of the methods described in paragraph (g)(6)(iii) of this section and by using the risk-free interest rate in applying the level payment method. On each successive anniversary date for the notional principal contract (a redetermination date) and each special redetermination date (as defined in paragraph (g)(6)(iv)(B) of this section), the taxpayer must redetermine the projected amount of each contingent nonpe-

riodic payment, reapply the level payment method as provided in paragraph (g)(6)(iv) of this section, and make the adjustments specified in paragraph (g)(6)(v) of this section. If paragraph (g)(4) of this section applies to the notional principal contract, redeterminations and adjustments must also be made to account for the time value components of the transaction as interest in accordance with that paragraph. Except for contingent nonperiodic payments governed by paragraph (g)(6)(iv)(B) of this section, in the taxable year in which a contingent payment is made or received, the parties must make appropriate adjustments to the amount of income or deductions attributable to the notional principal contract for any differences between projected and actual contingent nonperiodic payments as provided in paragraph (g)(6)(vi) of this section.

(iii) *Determining projected amount of contingent payment*—(A) *Payment based on actively traded futures or forward contracts.* If a contingent nonperiodic payment is determined under the contract by reference to the value of a specified index on a designated future date, the projected amount of the payment may be determined on the basis of the future value for the specified index in actively traded futures or forward contracts, if any, providing for delivery or settlement on the designated future date. If no actively traded contract exists for the designated future date, a determination from the future values for the specified index in actively traded futures or forward contracts, if any, providing for delivery or settlement on dates within three months of the designated future date may be used.

(B) *Payment based on extrapolation from current market prices.* If a contingent nonperiodic payment is determined under the contract by reference to the value of a specified index on a designated future date, the projected amount of the payment may be determined on the basis of the current value of the specified index as established by objective financial information adjusted to convert the current value to a future value for the specified index on the designated future date. The current value is converted to a future value by adding to the current value an amount equal to the accrual of interest on the current value under a constant yield method at the risk-free interest rate with appropriate

compounding and by making appropriate adjustments for expected cash payments on the property underlying the specified index.

(C) *Payment based on reasonable estimate.* If the methods provided in paragraphs (g)(6)(iii)(A) and (B) of this section do not result in a reasonable estimate of the amount of the contingent payment, the taxpayer must use another method that does result in a reasonable estimate of the amount of the contingent payment and that is based on objective financial information.

(iv) *Redeterminations of projected payments and level payment amounts*—(A) *General rule.* On each redetermination date, the taxpayer must redetermine the projected amount using current values on the redetermination date and the same method that was used on the commencement date of the notional principal contract, and must reapply the level payment method as of the commencement date of the notional principal contract on the basis of the new projected payment amount and the risk-free interest rate in effect on the redetermination date.

(B) *Special rule for fixed but deferred contingent nonperiodic payments.* If a contingent nonperiodic payment is fixed more than six months before it is due, and if the date the payment is fixed is in a different taxable year from the date the payment is due, the date on which the payment is fixed is a special redetermination date. As of that date, the taxpayer must treat the fixed amount as the projected amount for that contingent nonperiodic payment and apply paragraphs (g)(6)(iv) and (v) of this section as if the special redetermination date were a redetermination date.

(v) *Adjustments following redeterminations.* Following each redetermination of projected payments and level payment amounts, the taxpayer must apply the new schedule of level payments for purposes of determining amounts to be recognized in the current and subsequent taxable years with respect to the contingent nonperiodic payments. Any difference between the amounts recognized in prior taxable years and the amounts that would have been recognized in those years had the new level payment schedule been in effect for those years is taken into account as additional

payments or receipts with respect to the contract ratably over the one-year period beginning with the redetermination date and, to the extent attributable to a difference in the interest amounts calculated under paragraph (g)(4) of this section, is recognized as interest for all purposes of the Internal Revenue Code.

(vi) *Adjustments for differences between projected and actual payments.* Any difference between the amounts taken into account under paragraph (f) and this paragraph (g)(6) on the one hand and the amount of the actual payment under the contract on the other hand is taken into account as an adjustment to the net income or net deduction from the notional principal contract for the taxable year during which the payment occurs, and not as an adjustment to interest income or expense.

(vii) *Recordkeeping requirements.* The books and records maintained by a taxpayer must contain a description of the method used to determine the projected amount of a contingent payment, projected payment schedules, any adjustments following redeterminations, and any adjustments for differences between projected and actual contingent payments.

(7) \* \* \*

*Example 3. Upfront significant nonperiodic payment.* \* \* \*

\* \* \* \* \*

*Example 5. Backloaded significant nonperiodic payment.* (i) On January 1, 2003, unrelated parties *P* and *Q* enter into an interest rate swap contract. Under the terms of the contract, *P* agrees to make five annual payments to *Q* equal to LIBOR times a notional principal amount of \$100,000,000. In return, *Q* agrees to pay *P* 6% of \$100,000,000 annually, plus \$24,420,400 on December 31, 2007. At the time *P* and *Q* enter into this swap agreement, the rate for similar on-market swaps is LIBOR to 10%. Assume that on January 1, 2003, the risk-free rate is 10%.

(ii) The \$24,420,400 payment from *Q* to *P* is significant when compared to the present value of the total payments due from *Q* under the contract. Accordingly, pursuant to paragraph (g)(4) of this section, the transaction is recharacterized as two separate transactions. First, *P* is treated as paying to *Q* a series of \$4,000,000 level payment loan advances. The present value of the level payment loan advances equals the present value of \$24,420,400, the significant nonperiodic payment. Stated differently, the sum of the level payment loan advances and accrued interest on those advances equals the significant nonperiodic payment.

(iii) Next, *Q* is treated as using each loan advance to fund five annual level swap payments of \$4,000,000. The level payment loan advances and accrued interest on the advances computed with annual compounding at 10% are as follows:

	<i>Level Payment</i>	<i>Accrued Interest</i>
2003 .....	\$4,000,000	\$0
2004 .....	4,000,000	400,000
2005 .....	4,000,000	840,000
2006 .....	4,000,000	1,324,000
2007 .....	4,000,000	1,856,400
	\$20,000,000	\$4,420,400

(iv) *P* recognizes interest income, and *Q* accrues interest expense, each taxable year equal to the interest accruals on the deemed level payment loan advances. These interest amounts are not included in the parties' net income or net deduction from the swap contract under paragraph (d) of this section.

(v) The level payment amounts of \$4,000,000 are taken into account in determining the parties' net income and deductions on the swap pursuant to paragraph (d) of this section.

*Example 6. Contingent nonperiodic payment on an equity swap.* (i) On January 1, 2005, unrelated parties *V* and *W* enter into an equity swap contract. Under the terms of the contract, *V* agrees to make three annual payments to *W* equal to 1-year LIBOR times a notional principal amount of \$50,000,000. In return, *W* agrees to make a single payment on December 31, 2007, equal to the appreciation, if any, of a \$50,000,000 investment in a basket of equity securi-

ties over the term of the swap. *V* is obligated to make a single payment on December 31, 2007, equal to the depreciation, if any, in the same \$50,000,000 investment in the basket of equity securities. Assume that on January 1, 2005, 1-year LIBOR is 9.5%, and the risk-free rate is 10.0%.

(ii) This contract is a notional principal contract as defined in paragraph (c)(1) of this section. The annual LIBOR-based payments from *V* to *W* are periodic payments and the single payment on December 31, 2007, is a contingent nonperiodic payment.

(iii) Pursuant to the method described in (g)(6)(iii)(B) of this section, the parties determine that the projected amount of the contingent nonperiodic payment that *W* will pay *V* on December 31, 2007, is \$16,550,000. The present value of this projected fixed payment is significant when compared to the present value of the total payments due from *W* under the contract. Accordingly, pursuant

to paragraph (g)(4) of this section, the transaction is recharacterized as two separate transactions.

(iv) As a preliminary step, using the risk-free rate of 10.0% as the discount rate, the parties determine the level payment amounts that have a present value equal to the present value of \$16,550,000, the projected significant nonperiodic payment. Stated differently, the sum of the level payment amounts and accrued interest at 10.0% on those amounts must equal the projected significant nonperiodic payment. The level payment amounts thus determined are \$5,000,000.

(v) Next, *V* is treated as paying to *W* a series of \$5,000,000 loan advances.

(vi) Then, *W* is treated as using each loan advance to fund one of the three annual level swap payments of \$5,000,000. The level payment loan advances and accrued interest on the advances computed with annual compounding at 10.0% are as follows:

	<i>Level Payment</i>	<i>Accrued Interest</i>
2005 .....	\$5,000,000	\$0
2006 .....	5,000,000	500,000
2007 .....	5,000,000	1,050,000
	\$15,000,000	\$1,550,000

(vii) No interest amount is taken into account for the contract year 2005.

(viii) The level payment amount of \$5,000,000 is taken into account for the contract year 2005 in determining the parties' net income and deductions on the swap pursuant to paragraph (d) of this section.

(ix) For the contract year 2005, *V* makes a swap payment to *W* equal to 1-year LIBOR at 9.5% times \$50,000,000, or \$4,750,000, and *W* is deemed to make a swap payment to *V* equal to the annual level payment of \$5,000,000. The net of the ratable daily portions of these payments determines the annual net income or deduction from the contract for both *V* and *W*.

*Example 7. Initial Adjustment.* (i) The terms of the equity swap agreement are the same as in *Example 6*. In addition, assume that on January 1, 2006, the

first redetermination date, 1-year LIBOR is 10.0%, and the risk-free rate is 10.5%. On that date, the parties redetermine the projected amount of the contingent nonperiodic payment using current values in effect on that date. Under the method described in (g)(6)(iii)(B) of this section, the parties determine that the reprojected amount of the contingent nonperiodic payment that *W* will pay *V* on December 31, 2007, is \$23,261,500. The present value as of January 1, 2005, of this projected fixed payment is significant when compared to the present value of the total payments due from *W* under the contract. Accordingly, pursuant to paragraph (g)(4) of this section, the transaction is recharacterized as two separate transactions.

(ii) The parties use the redetermined projected amount of \$23,261,500, to reapply the method provided by paragraph (g)(4) of this section effective as

of the commencement date of the swap. As a preliminary step, using the risk-free rate of 10.5% as the discount rate, the parties determine the level payment amounts that have a present value equal to the present value of \$23,261,500, the reprojected significant nonperiodic payment. Stated differently, the sum of the level payment amounts and accrued interest at 10.5% on those amounts must equal the reprojected significant nonperiodic payment. The level payment amounts thus determined are \$6,993,784.

(iii) Next, *V* is treated as paying to *W* a series of \$6,993,784 loan advances.

(iv) Then, *W* is treated as using each loan advance to fund one of the three annual level swap payments of \$6,993,784. The level payment loan advances and accrued interest on the advances computed with annual compounding at 10.5%, are as follows:

	<i>Level Payment</i>	<i>Accrued Interest</i>
2005 .....	\$6,993,784	\$0
2006 .....	6,993,784	734,347
2007 .....	6,993,784	1,545,801
	\$20,981,352	\$2,280,148

(v) For the contract year 2006, *V* recognizes interest income, and *W* accrues interest expense equal to the accrued interest of \$734,347 on the deemed level payment loan advance. These interest amounts are not included in the parties' net income or net deduction from the swap contract under paragraph (d) of this section.

(vi) The level payment amount of \$6,993,784 is taken into account for the contract year 2006 in determining the parties' net income and deductions on the swap pursuant to paragraph (d) of this section.

(vii) The parties also take into account for the contract year 2006 the difference between the amount recognized for 2005 and the amount that would have been recognized in 2005 had the new level payment schedule in this *Example 7* been in effect in 2005. Thus, for purposes of paragraph (d) of this section, *W* is treated as making a swap payment, and *V* is treated as receiving a swap payment of \$1,993,784 (\$6,993,784 - \$5,000,000) for purposes of paragraph (d) of this section.

(viii) For the contract year 2006, *V* makes a swap payment to *W* equal to 1-year LIBOR at 10.0% times \$50,000,000, or \$5,000,000, and *W* is deemed to make a swap payment to *V* equal to the annual level payment of \$6,993,784 and the adjustment amount of \$1,993,784. The net of the ratable daily portions of these payments determines the annual net income or deduction from the contract for both *V* and *W*.

*Example 8. Subsequent Adjustment.* (i) The terms of the equity swap agreement are the same as in *Example 7*. In addition, assume that on January 1, 2007, the second redetermination date, 1-year LIBOR is 11.0%, and the risk-free rate is also 11.0%. On that date, the parties redetermine the projected amount of the contingent nonperiodic payment using current values in effect on that date. The parties determine that the reprojected amount of the contingent nonperiodic payment that *W* will pay *V* on December 31, 2007, is \$11,050,000. The present value as of January 1, 2005, of this projected fixed payment is significant when compared to the present value of the total payments due from *W* under the contract. Accordingly,

pursuant to paragraph (g)(4) of this section, the transaction is recharacterized as two separate transactions.

(ii) The parties use the redetermined projected amount of \$11,050,000, to reapply the method provided by paragraph (g)(4) effective as of the commencement date of the swap. As a preliminary step, using the risk-free rate of 11.0% as the discount rate, the parties determine the level payment amounts that have a present value equal to the present value of \$11,050,000, the reprojected significant nonperiodic payment. Stated differently, the sum of the level payment amounts and accrued interest at 11.0% on those amounts must equal the reprojected significant nonperiodic payment. The level payment amounts thus determined are \$3,306,304.

(iii) Next, *V* is treated as paying to *W* a series of \$3,306,304 loan advances.

(iv) Then, *W* is treated as using each loan advance to fund one of the three annual level swap payments of \$3,306,304. The level payment loan advances and accrued interest on the loan advances computed with annual compounding at 11.0% are as follows:

	<i>Level Payment</i>	<i>Accrued Interest</i>
2005 .....	\$3,306,304	\$0
2006 .....	3,306,304	363,693
2007 .....	3,306,304	767,393
	\$9,918,912	\$1,131,086

(v) For 2007, *V* recognizes interest income, and *W* accrues interest expense equal to the \$767,393 accrued interest amount for 2007 on the deemed loan advances. In addition, *V* has a net interest expense item and *W* has a net interest income item equal to \$370,654 (\$734,347 - 363,693), the difference between the interest accrual taken into account for 2006 and the amount that would have been taken into account for 2006 had the new level payment schedule in this *Example 8* been in effect for 2006. As a result, *V* has net interest income and *W* has net interest expense in the amount of \$396,739 for 2007. These interest amounts are not included in the parties' net income or net deduction from the swap contract under paragraph (d) of this section.

(vi) The level payment amount of \$3,306,304 is taken into account for the contract year 2007 in determining the parties' net income and deductions on the swap pursuant to paragraph (d) of this section.

(vii) For 2007, the parties also take into account for 2007 the difference between the amounts previously recognized for 2005 and 2006 and the amounts that would have been recognized for those years had the new level payment schedule in this *Example 8* been in effect in 2005 and 2006. The amounts

previously recognized were: a total of \$6,993,784 for 2005, which is the sum of \$5,000,000 (in 2005) and \$1,993,784 (in 2006), and a total of \$6,993,784 for 2006 (in 2006). The adjustment amount, therefore, equals two times \$3,687,480 (\$6,993,784 - \$3,306,304), or \$7,374,960. This amount is taken into account as a payment for purposes of paragraph (d) of this section.

(viii) For the contract year 2007, *V* makes a swap payment to *W* equal to 1-year LIBOR at 11.0% times \$5,000,000, or \$5,500,000. *W* is deemed to make a swap payment to *V* equal to the annual level payment for 2007 of \$3,306,304, and *V* is deemed to make a swap payment to *W* equal to the adjustment amount of \$7,374,960. The net of the ratable daily portions of these payments determines the annual net income or deduction from the contract for both *V* and *W*.

*Example 9. Adjustment for actual payment.* (i) The terms of the equity swap agreement are the same as in *Example 8*. In addition, on December 31, 2007, *W* makes a payment to *V* of \$25,000,000, an amount equal to the appreciation of a \$50,000,000 investment in the basket of equity securities.

(ii) For 2007, \$13,950,000, the difference between \$25,000,000 and \$11,050,000, the projected

amount of the contingent payment as of January 1, 2007, is taken into account as an adjustment to the parties' net income or deductions for each party's taxable year that contains December 31, 2007, pursuant to paragraph (d) of this section.

\* \* \* \* \*

(i) *Election to mark to market.* A taxpayer may elect to mark to market notional principal contracts providing for nonperiodic payments. The rules of paragraphs (f) (other than (f)(2)(i)), (g)(6)(ii) through (vii), and (h) of this section do not apply to contracts to which this paragraph (i) applies. See paragraph (i)(5) of this section for rules respecting interest accruals under paragraph (g)(4) of this section for contracts providing for significant nonperiodic payments to which this paragraph (i) applies.

(1) *General rule.* In the case of any contract held at the close of the taxable

year to which this paragraph (i) applies, the taxpayer shall determine income inclusions and deductions by reference to the gain or loss that would be realized if the contract were sold for its fair market value on the last business day of the taxable year. Proper adjustment shall be made in the amount of any gain or loss subsequently realized (or calculated) for the income inclusions and deductions taken into account by reason of this paragraph (i)(1) as provided in paragraph (d)(2) of this section.

(2) *Scope of election.* The election provided by this paragraph is available for notional principal contracts that are—

(i) Of a type that is actively traded within the meaning of §1.1092(d)–1(c) (determined without regard to the limitation in §1.1092(d)–1(c)(2));

(ii) Marked to market by the taxpayer for purposes of determining the taxpayer's financial income provided the taxpayer satisfies the requirements in paragraph (i)(4) of this section;

(iii) Subject to an agreement by a party to the contract that is subject to section 475 to supply to the taxpayer the value that it uses in applying section 475(a)(2); or

(iv) Marked to market by a regulated investment company described in section 1296(e)(2).

(3) *Determination of fair market value.* For purposes of paragraph (i)(1) of this section, fair market value is determined by applying the rules set forth in paragraphs (i)(3)(i) through (iv) of this section.

(i) *Determination based on readily ascertainable value.* For a contract described in paragraph (i)(2)(i) of this section, fair market value is determined based on the mean between the bid and asked prices quoted for the contract on an established financial market as defined in §1.1092(d)–1(b)(1), or, if bid and asked prices are not available, comparable prices determined on the basis of recent price quotations described in §1.1092(d)–1(b)(2).

(ii) *Determination based on value used for financial statements.* For a contract described in paragraph (i)(2)(ii) of this section that is not described in paragraph (i)(2)(i) of this section, fair market value is the value used by the taxpayer for purposes of preparing its financial statements under paragraph (i)(4) of this section.

(iii) *Determination based on counterparty's mark-to-market value.* For a con-

tract described in paragraph (i)(2)(iii) of this section that is not described in paragraph (i)(2)(i) of this section, fair market value is the mark-to-market value provided by a counterparty as being the value the counterparty used for purposes of section 475(a)(2).

(iv) *Determination based on value used in determining net asset value.* Notwithstanding paragraphs (i)(3)(i) through (iii) of this section, for a contract described in paragraph (i)(2)(iv) of this section, fair market value is the value used by the taxpayer in determining its net asset value.

(4) *Requirements for use of financial statement values.* [Reserved].

(5) *Notional principal contracts accruing interest on significant nonperiodic payments—(i) General rule.* If a notional principal contract that is marked to market under this paragraph (i) provides for one or more significant nonperiodic payments, paragraph (g)(4) of this section applies to the contract (computed with regard to the rule in paragraph (i)(5)(ii) of this section). Proper adjustment shall be made in the amount of any income inclusions or deductions recognized under paragraph (i)(1) of this section to take into account amounts recognized as interest under paragraph (g)(4) of this section and the payment or receipt of the nonperiodic payment or payments.

(ii) *Special rules for significant contingent nonperiodic payments.* In the case of a contract providing for a significant contingent nonperiodic payment, the projected amount of the payment is determined by applying one of the methods described in paragraph (g)(6)(iii) of this section or by applying the deemed equivalent value method described in this paragraph (i)(5)(ii). The amount of the payment is not redetermined except as provided in paragraph (g)(6)(iv)(B) of this section. The deemed equivalent value method may be applied if the contract fixes the timing and amount of all of the payments under the contract, except for a sole significant contingent nonperiodic payment. Under the deemed equivalent value method, the amount of the significant contingent nonperiodic payment is the amount that, as of the date the terms of the contract are fixed, causes the present value of all of the payments by the taxpayer to equal the present value of all of the payments of the counterparty to the contract. The present

value of each payment of the contract is determined by applying the risk-free interest rate.

(iii) *Nonapplicability to regulated investment companies.* Paragraphs (i)(5)(i) and (ii) of this section do not apply to a regulated investment company described in paragraph (i)(2)(iv) of this section that makes an election under paragraph (i) of this section.

(6) *Election.* An election to apply this paragraph (i) must be made with respect to all notional principal contracts described in paragraph (i)(2) of this section to which the taxpayer is a party. The election must be made in the time and manner prescribed by the Commissioner and is effective for the taxable year for which made and all subsequent taxable years, unless revoked with the consent of the Commissioner.

(j) *Effective dates—(1) General rule.* Except as provided in paragraph (j)(2) of this section, this section is applicable for notional principal contracts entered into on or after December 13, 1993.

(2) *Exception.* Paragraphs (g)(6) (other than (g)(6)(i)) and (i) of this section are applicable for notional principal contracts entered into on or after 30 days after the date a Treasury decision based on these proposed regulations is published in the **Federal Register**.

Par. 5. Section 1.1234A–1 is added to read as follows:

*§1.1234A–1 Notional principal contracts, bullet swaps, and forward contracts.*

(a) *General rule.* If a taxpayer has a position in a notional principal contract governed by the rules of §1.446–3, any gain or loss arising from a termination payment as defined in §1.446–3(h)(1) is treated as gain or loss from a termination of the notional principal contract.

(b) *Nonapplicability to payments other than termination payments.* For purposes of section 1234A, none of the following payments terminate or cancel a right or obligation: a periodic payment described in §1.446–3(e), a nonperiodic payment described in §1.446–3(f), a contingent nonperiodic payment described in §1.446–3(g)(6) to which §1.446–3(g)(6)(ii) applies, or mark-to-market income inclusions and deductions described in §1.446–3(i)(1). Accordingly, section 1234A does not ap-

ply to any of these items, including any final scheduled payment. If a payment made or received pursuant to a notional principal contract is not a termination payment as defined in §1.446-3(h)(1), the payment constitutes ordinary income or expense. See sections 162 and 212 and the regulations thereunder.

(c) *Bullets swaps and forward contracts*—(1) Any gain or loss arising from the settlement of obligations under a bullet swap or forward contract (including a payment pursuant to the terms of the obligations) is treated as gain or loss from a termination of the bullet swap or forward contract.

(2) *Definition of bullet swap.* A bullet swap is a financial instrument that is not an excluded contract as defined in §1.446-3(c)(1)(ii), that provides for the computation of an amount or amounts due from one party to another by reference to a specified index upon a notional principal amount, and that provides for settlement of all the parties' obligations at or close to maturity of the contract.

(d) *Effective date.* Paragraphs (b)(1) and (c) of this section are applicable to notional principal contracts, bullet swaps, and forward contracts entered into on or after 30 days after the date a Treasury decision based on these proposed regulations is published in the **Federal Register**.

Mark E. Matthews,  
*Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on February 25, 2004, 8:45 a.m., and published in the issue of the Federal Register for February 26, 2004, 69 F.R. 8886)

## Revision of Form 3115

### Announcement 2004-16

#### DECEMBER 2003 REVISION OF FORM 3115

Form 3115, *Application for Change in Accounting Method*, and its instructions have been revised. This December 2003 revision is the current Form 3115 and replaces the May 1999 version of the Form 3115.

In general, a taxpayer requesting a change in accounting method must complete and file a current Form 3115. See

section 8.06 of Rev. Proc. 97-27, 1997-1 C.B. 680 (as modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, as amplified and clarified by Rev. Proc. 2002-54, 2002-2 C.B. 432). See also Rev. Proc. 2002-9, 2002-1 C.B. 327 (as modified and clarified by Announcement 2002-17, 2002-1 C.B. 561, modified and amplified by Rev. Proc. 2002-19, 2002-1 C.B. 696, and amplified, clarified and modified by Rev. Proc. 2002-54, 2002-2 C.B. 432). To allow a reasonable transition period to the December 2003 Form 3115, the Service will accept either the May 1999 Form 3115 or the December 2003 Form 3115 through May 31, 2004, except where the use of the December 2003 Form 3115 is specifically required in guidance published by the IRS. Taxpayers filing Forms 3115 after May 31, 2004, must use the December 2003 Form 3115. The Service encourages taxpayers to use the December 2003 Form 3115 prior to June 1, 2004.

When requesting a change in accounting method, the applicant must provide the requested information to be eligible for approval of the requested accounting method change. The applicant may be required to provide information specific to the accounting method change such as an attached statement. The applicant must provide all information relevant to the requested accounting method change, even if not specifically requested by the Form 3115.

The December 2003 Form 3115 and instructions may be downloaded or ordered using the IRS website, [www.irs.gov](http://www.irs.gov), and will be available at many local IRS offices. In addition, the December 2003 Form 3115 and instructions may be ordered by telephone by calling 1-800-TAX FORM (1-800-829-3676).

#### EFFECT OF THE DECEMBER 2003 FORM 3115 ON OTHER DOCUMENTS

The following revenue procedures contain references to specific sections of the Form 3115. Those references to the Form 3115 are modified to reflect the December 2003 Form 3115, as follows.

In Rev. Proc. 2001-10, 2001-1 C.B. 272, section 6.02(1)(d), the reference to "Part III (regarding the § 481(a) adjustment)" is modified to refer to "Part IV (regarding the § 481(a) adjustment)."

In Rev. Proc. 2001-23, 2001-1 C.B. 784, section 5.02(4), the reference to "Part I of Schedule B" is modified to refer to "Part I of Schedule C."

In Rev. Proc. 2002-9, section 10.04(4)(c) of the Appendix, the reference to "Part I of Schedule B" is modified to refer to "Part I of Schedule C."

In Rev. Proc. 2002-28, 2002-1 C.B. 815, section 7.02(1)(b), the reference to "Part III of Form 3115 (regarding the § 481(a) adjustment)" is modified to refer to "Part IV of Form 3115 (regarding the § 481(a) adjustment)."

For further information regarding this announcement, contact Brenda D. Wilson at (202) 622-4800 (not a toll-free call).

## Foundations Status of Certain Organizations

### Announcement 2004-19

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:

100 Black Men of America, Inc., Greater Dallas Chapter, Dallas, TX  
100 Blacks Who Care, Inc., Brooklyn, NY  
Addison Terrace High Rise Resident Council, Pittsburgh, PA  
African Centre for the Constructive Resolution of Disputes, New York, NY  
African Liberation League, Los Angeles, CA  
African Refugees Relief Organization, Inc., Atlanta, GA  
Agape Life Center, Wichita, KS  
Agape Productions, Inc., Passaic, NJ

Ambassadors For Christ Family Enhancement, Inc., Miami, FL  
 American Friends of Children of Africa, Dover, DE  
 American Friends of Masterprize, Inc., San Francisco, CA  
 Andrea Levine Foundation, Cherry Hill, NJ  
 Angel of Mercy Group Home, Inc., Hacienda Heights, CA  
 Anti-Racist Education, Columbus, OH  
 Appalachian Counseling Foundation, Portsmouth, OH  
 Armenian International Womens Association Los Angeles Affiliate, Inc., Glendale, CA  
 Arts Engine, Inc., Beverly Hills, CA  
 Arts Incorporated in Human Services Ltd., Rego Park, NY  
 Ashtabula County Foster Parent Support Group, Geneva, OH  
 Badrock Fire and Quick Response Unit, Columbia Falls, MT  
 Bar & Restaurant Service, Inc., Providence, RI  
 Barbaras Playhouse a Haven For Little Angels, Inc., West Palm Beach, FL  
 Basic Care of Greenfield, Inc., Greenfield, OH  
 Beyth Millo Ministries, Inc., Blairsville, GA  
 Black Star Housing Development, Inc., Houston, TX  
 Bookmark Production, Inc., Providence, RI  
 Boys and Girls Club of Lamar County, Purvis, MS  
 Bruce Coslets Executives for Charity, W. Chester, OH  
 Building Links, Inc., Ithaca, NY  
 Buy American Campaign, Inc., Laguna Hills, CA  
 California Organization For Assistive Technology Support, Orange, CA  
 Calvary Cathedral International, Inc., Fort Worth, TX  
 Capital Properties, Inc., Birmingham, AL  
 Carey Hill Development Corporation, Inc., North Augusta, SC  
 Caring For Families, Leiceister, NC  
 Cass County Boys & Girls Club, Inc., Atlanta, TX  
 Central New Life Outreach Ministries, Inc., Anchorage, AK  
 Charity Human Services Organization, Inc., Freeport, NY  
 Charles T. Carter Pastoral Education Foundation, Birmingham, AL  
 Christian Helping Hands, Inc., Port Chester, NY  
 Christian Rescue Mission, Inc., Dayton, OH  
 Cincinnati Spikes, Cincinnati, OH  
 Citizens For Recreation, Inc., Enosburg Falls, VT  
 Classicway Cagers, Cincinnati, OH  
 Clear Vision Foundation, Montpelier, VT  
 Clinica San Pablo, El Monte, CA  
 Clinical Research Network, Inc., Scotch Plains, NJ  
 Coalition For a Safer Healthier Community, Kerrville, TX  
 Collier County Community Tennis Foundation, Marco Island, FL  
 Combined Fraternal Organizations of South Phoenix, Phoenix, AZ  
 Commercial Assistance Program, Inc., Summit, NJ  
 Commonwealth Landmarks Foundation, Oil City, PA  
 Community Improvement Corporation of New Richmond Ohio, New Richmond, OH  
 Community Support Initiative, Inc., Pittsburgh, PA  
 Community Youth Development Services, Columbus, OH  
 Conservative Front, Inc., Athens, OH  
 Consumer Debt Management Corp., Rockville, MD  
 Cook Communications Ministries International, Inc., Colorado Springs, CO  
 Council For Public Deliberation, Columbus, OH  
 Councils of Governments of Beaver & Butler Counties, Aliquippa, PA  
 Counseling & Education Foundation For Texas Youth, Houston, TX  
 Court Street Common, Inc., Exeter, NH  
 Craighead County Citizens For Decency, Inc., Jonesboro, AR  
 Creative Clowns Under Construction, Inc., Mount Vernon, OH  
 Creative Community Development and Housing Corporation, Richmond, VA  
 Crepe Myrtle, Memphis, TN  
 Crime Victims Legal Assistance, Philadelphia, PA  
 Cultural Society of Inland Empire, Apple Valley, CA  
 D B Funds, Inc., Dallas, TX  
 Dare to Dream Foundation, Inc., Tuskegee, AL  
 Dauphin County Economic Development Corp., Harrisburg, PA  
 Davids Heart, Euless, TX  
 Delta Lambda Sigma Chapter of Phi Beta Sigma, Inc., Port Pierce, FL  
 Destiny Ministries, Columbus, OH  
 Discipling Com, San Diego, CA  
 District of Northwest Schools Foundation, Cincinnati, OH  
 Doctors Care Project of Bakersfield, Bakersfield, CA  
 Drinkers Against Drunk Drivers, Concord, CA  
 Earth Rise Spirituality and Educational Center, Inc., Scranton, PA  
 East Canton Community Sports Complex Committee, East Canton, OH  
 East Cleveland Park Commission, Cleveland, OH  
 East Orange Urban Renewal Housing Development Corporation, Newark, NJ  
 Edon Summer Ball League, Edon, OH  
 Education For Industry, Sayre, PA  
 El Rescate Development Fund, Inc., Los Angeles, CA  
 Elders Place II, Inc., Philadelphia, PA  
 Electra Productions, Inc., New Orleans, LA  
 Emergency Management Volunteers, San Diego, CA  
 Enjoy Theatre, Inc., Columbus, OH  
 Envisions Learning Center, Sherman, TX  
 Esther L. Stewart Memorial Fund, Inc., Dublin, OH  
 Euharlee Valley Historical Society, Rockmart, GA  
 Expressions For Life Funding Foundation, Tahoe Vista, CA  
 External Educational Resources, Inc., Portland, ME  
 EZ Transportation, Inc., Toledo, OH  
 Facts of Life, Lodi, CA  
 Fair Elections Commissions, Shippensburg, PA  
 Faith Temple New Hope Community Development Corporation, East Orange, NJ  
 Feed Our Children Ministries, Inc., Sarasota, FL  
 Fertile Ground Ministries, Decatur, AL  
 First Things Corp., St. Louis, MO  
 Florida Community Homes, Inc., Ft. Lauderdale, FL  
 Fondazione Regionale Christoforo Colombo, Italy  
 Foundation For Educational Alternatives in the Rural South, Macon, MS  
 Foundation For Health in Aging, Inc., New York, NY

Foundation For Understanding Chinese Business, Kingston, PA  
 Foundation Maria of Nevada, Las Vegas, NV  
 Fraternidad Peruana De Utah, Murray, UT  
 Freeburg Area Community Development Assn., Freeburg, IL  
 Freeport Baseball Association, Freeport, PA  
 Friends Glen, Philadelphia, PA  
 Friends of Ash, Allentown, PA  
 Friends of Children Society, Vancouver, WA  
 Friends of Gummi, Inc., Naples, FL  
 Friends of Phoenix Advantage Charter School, Inc., Phoenix, AZ  
 Friends of the Boardwalk, Inc., Brooklyn, NY  
 Friends of the Great Falls Library, Great Falls, VA  
 Friends of the Hallstead-Great Bend Ranch Library, Hallstead, PA  
 Gallman National Historic District Association, Inc., Gallman, MS  
 Galveston Humane Society, Galveston, TX  
 GAM Home Aid, Inc., Nashville, TN  
 Gateppis Balloons, Waynesboro, VA  
 Georgetown Alliance For Liberty and Freedom, Washington, DC  
 Germantown-Venango Farmers Market Community Development Corp., Philadelphia, PA  
 Gibbs Community Foundation, Oakland, CA  
 GIF Outreach, Inc., Elizabethtown, KY  
 Glenville Health Foundation, Cleveland, OH  
 Glory Foundation, Columbia, SC  
 God First, North Hollywood, CA  
 Good Ground Ministries, Cottonport, LA  
 Good Orderly Direction, Lorain, OH  
 Good Messenger, Antelope, CA  
 Good Samaritan Ministries, Fort Scott, KS  
 Goshen Cancer Foundation, Pataskala, OH  
 Gotell Communications, Dallas, TX  
 Grace Institute, Shaker Heights, OH  
 Grace Retirement Centers, Inc., Pasadena, TX  
 GRC-II Charities, Inc., Middletown, NY  
 Great Divide Orchid Society, Helena, MT  
 Greenhouse Ministries, Inc., Lebanon, OH  
 Greenwich 2000, Ltd., More Philips & Duncan PC, Greenwich, CT  
 Growing Peace Foundation, Kettering, OH  
 Guernsey County Society For the Physically Challenged, Inc., Cambridge, OH  
 Haitian Agency Cultural & Technical Corporation, Atlanta, GA  
 Hale Ohana O Kapaa, Kapaa, HI  
 Hanai I Ka Uhane O Na Keiki to Foster the Spirit of Children, Honolulu, HI  
 Harvey Community Center, Harvey, IL  
 Heart Rock TV, Inc., Franklin, TN  
 Helping Educators Remove Obstacles, Akron, OH  
 Helping Hand For Relief & Development, Inc., Farmingdale, NY  
 Heritage Center For Human and Community Development, Inc., Birmingham, AL  
 Hillcrest Community Services & Free Store, Amelia, OH  
 His Arms Extended Community Outreach Center, Inc., Pompano Beach, FL  
 His Image Creations, Pickerington, OH  
 Hollies Hope, Inc., Metairie, LA  
 Housing Partners Community Development Corporation, Ambler, PA  
 Huggle, Inc., Miami, FL  
 Humane Society of Beaverhead County, Dillon, MT  
 I E C A Foundation of Arizona, Inc., Phoenix, AZ  
 Illyrian Group, Inc., Los Angeles, CA  
 In Motion Sports, Inc., Newport, KY  
 Inner City Perceptions, Inc., Arnold, PA  
 Inspired Ministries, Potrero, CA  
 Institute For Ethics in Education, Hudson, OH  
 Institute For the Economic Development of Children, Philadelphia, PA  
 Institute For the Study of the Magisterial Teaching of the Church, Worcester, MA  
 Institute of Genetics Education, Santa Fe, NM  
 Inter Denominational Energy and Economic Development Coalition, Philadelphia, PA  
 International Football Club of Pennsylvania, Murrysville, PA  
 International Institute of S P O R T, Inc., Georgetown, TX  
 International Shalom Institute, Inc., Miami Beach, FL  
 International Society of Otrhlnrngc Allergy and Immunology, Inc., Pittsburgh, PA  
 Isaiah Services, Laguna Hills, CA  
 Istanbul Heritage Fune, Inc., New York, NY  
 Jackson Purchase Transportation Museum, Inc., Benton, KY  
 James Buddy McGirt Foundation For Children, New York, NY  
 JCLS Ministries, Inc., Camden, OH  
 Jesus Fellowship, San Diego, CA  
 Joe Robbie Foundation For Children, Boulder, CO  
 John & Ada Diedrich 4-H Camp, Inc., Worthington, KY  
 Ju-Jitsu Shotokan Karate Association, Darby, PA  
 Kansas Ferret Association KFA, Lawrence, KS  
 Kay Baxter Foundation, Inc., Spring Valley, NY  
 Kealihoooneaiana the Dallas Mossman Voegler Ohana, Honolulu, HI  
 Keep the Faith Foundation, Inc., Jackson, MS  
 Keeshond Sunshine Rescue Foundation, Woodbury, MN  
 Keystone Center of Music and the Arts, Milford, PA  
 Kid Power, Olympia, WA  
 Kiddy City Development Center, Inc., Chicago, IL  
 Kingdom Harvest Ministries, Inc., Los Angeles, CA  
 Koleinu, Reynoldsburg, OH  
 Ladies of Essence, Waterloo, IA  
 Land of Flourishing Virtue, Inc., San Gabriel, CA  
 Leadership Center, Houston, TX  
 Leadership Potential, Inc., Avondale Est, GA  
 Lee County Lacrosse, Inc., Fort Myers, FL  
 Levine & West Group Home For Boys, Hawthorne, CA  
 Liberty Place Clubhouse, Pittsburgh, PA  
 Life Concerns Education and Counseling, Inc., Cincinnati, OH  
 Louisiana Repertory Theatre Company, Houma, LA  
 Lovell Johnson Quality of Life Center, Incorporated, Milwaukee, WI  
 Loveman Village Resident Council, Inc., Birmingham, AL  
 Lucas Outdoor, Inc., Washington Court House, OH  
 M-Pact Youth Services, Cincinnati, OH  
 Mack Ministries, Toledo, OH  
 Maria Olberding Foundation, Cincinnati, OH  
 Maryland Mountain Trust, Inc., Lonaconing, MD  
 Mastee International, Annandale, VA  
 Master of Breakthroughs, Baltimore, MD  
 Matthew Harrington Memorial Fund, Jamison, PA  
 MCPBA Foundation, Inc., Miami, FL

Mentoring For Occupational Readiness and Employment, St. Charles, IL  
Merrifield Estates, Inc., Portsmouth, VA  
Messiah International Foundation, Beverly Hills, CA  
Mi Casa Su Casa Housing Development Corporation, Menlo Park, CA  
Mid Atlantic Golfers Association, Inc., Atlanta, GA  
Middle Road Foundation, Santa Fe, NM  
Millennium Center For Digital History, Washington, DC  
Millennium Philadelphia Celebration, Philadelphia, PA  
Mine Victims Fund, Charlottesville, VA  
Mineola Senior Citizens Center, Inc., Mineola, TX  
Mission Emmanuel, Portland, OR  
Mobility Impaired Resources, Inc., Billings, MT  
Montana Mining Association-Mine Safety Program, Helena, MT  
Mortal Angels, Inc., Carson, CA  
Motion Picture Industry Charitable Alliance, Springfield, OH  
Mount Carmel Area School District Education Foundation, Mount Carmel, PA  
Mu Chapter of Sigma Chi Foundation, Granville, OH  
Mu Sigma Zeta Chapter of Zeta Phi Beta Sorority, Inc., San Diego, CA  
Multicultural Art Academy, Dallas, TX  
N B Cbethel-U S A Housing, Inc., Thirty Two, Newark, OH  
Name Center — Pelham, Pelham, AL  
NATAS Northwest Regional Scholarship Foundation, Seattle, WA  
National Nephrology Technical Certification Board, Sunnyvale, CA  
National Voluntary Health Facility 5, Inc., Brooklyn, NY  
Neighborhood Investment Resources, Dayton, OH  
Neighborhood Learning Options, Inc., Germantown, MD  
Neighborhood Storehouse Association, Inc., Third Street, GA  
Nevada Association of State and Drug Abuse Programs, Las Vegas, NV  
New Community Builders, Inc., Jersey City, NJ  
New Concept Visions 2000, Inc., Hollywood, FL  
New Covenant Development Foundation, Heath Springs, SC  
New Mexico Hispano Entertainers Association, Albuquerque, NM  
Nisan Young Women Leaders USA, Inc., New York, NY  
North Carolina Association of Black Lawyers Foundation, Inc., Durham, NC  
North Carolina Association on Aging Foundation, Rocky Mount, NC  
North Carolina Dance & Dance Sport Foundation, Raleigh, NC  
North Central Pennsylvania Ice Sports, Inc., Williamsport, PA  
North Hardin Youth Cheerleading League, Inc., Radcliff, KY  
North Star Foundation, Cedar City, UT  
Northridge Pee Wee Football Association, Dayton, OH  
Northside Center For Women, Inc., S. Hamilton, MA  
Northumberland County Organizational Resources For Community Outreach, Kulpmont, PA  
Oaks Group, Inc., San Antonio, TX  
Oasis Community Development Corporation, Camden, NJ  
Ohio Campus Ministry For Korean Students, Inc., Huber Heights, OH  
Ohio Community Schools Center, Columbus, OH  
Ohio Firefighters Benevolent Fund, Cincinnati, OH  
Ohio High School Cup, Springfield, OH  
Ohio Premier Too, Inc., Dublin, OH  
Ohio Valley Boxing, Inc., Dayton, OH  
Ohio Valley Youth Athletics, Inc., Dayton, OH  
Old Logandale School Historical and Cultural Society, Logandale, NV  
Olentangy Heritage Foundation, Delaware, OH  
One Community One Goal, Inc., Miami, FL  
Opera For Everyone, Inc., Havertown, PA  
Opera Institute of California, San Jose, CA  
Orchard Place East at Spartanburg, Inc., Columbia, SC  
Oxford Animal Rescue Foundation, Inc., Camden, OH  
Parade Street Development Corporation, Erie, PA  
Parents and Children Against Drugs, Philadelphia, PA  
Parents Backing Students, Baton Rouge, LA  
Parents Empowerment Coalition, Cincinnati, OH  
Partners For Human Progress, Inc., Somers, NY  
Patrick F. Knapp Scholarship Fund, Central City, PA  
Peerspectives, Inc., Syracuse, NY  
Peggy Still Foundation For Creation & Education of New Music, Inc., Roswell, GA  
Pennsylvania Performing Arts Company, North Wales, PA  
Pentecostes Siglo XXI, Anaheim, CA  
Philadelphia Polo Club, Inc., Villanova, PA  
Philip Procaccino Memorial Scholarship Fund, Vineland, NJ  
Phoenix House, Inc., Warren, PA  
Physicians Council For the Hearing Impaired, Huntington Beach, CA  
Pike County Youth Soccer League, Waverly, OH  
Playback Theatre Midwest, Chicago, IL  
Plover Hill Productions, Inc., Ipswich, MA  
Plum Street Foundation, Philadelphia, PA  
Polacek Family Human Needs Fund, Johnstown, PA  
Police and Community Together Community Volunteer Services, Tacoma, WA  
Polish American Radiological Education Trust, Boston, MA  
Polk Community Preschools Association, Inc., Winter Haven, FL  
Poor Box Consortium For the Arts, Westerville, OH  
Poplar Bluff Soccer Club, Inc., Poplar Bluff, MO  
Pot Belly Pig Rescue, Inc., Las Vegas, NV  
Powhatan Fair Association, Powhatan, VA  
Praise and Worship Ministries, Dublin, OH  
Prillerman, Columbus, OH  
Primera Iglesia Cristiana Nueva Vida Amor Y Verdad, Inc., Buffalo, NY  
Professional Cosmetologists and Barbers Association, Cincinnati, OH  
Progressive Youth Foundation, Danville, CA  
Project Enrichment, Cincinnati, OH  
Project Feel Better, Inc., White Plains, NY  
Project Green of Montana, Inc., Butte, MT  
Prospect Terrace Resident Council, E. Pittsburgh, PA  
Public Education Foundation of Monroe County, Inc., Monroeville, AL  
Purpose For Life Foundation, Columbus, OH  
R Carolina Life Center, Kershaw, SC  
Rainbow Farms Therapeutic Riding Center, Inc., Atlanta, GA  
Rainbows End, Inc., Poland, OH  
Rankin Arts Coalition, Inc., Brandon, MS

Reach Out Ministries, Springfield, OH  
 Real Hope Cafe, Fisher, WV  
 Recovery Foundation, Inc., Miami, FL  
 Redeeming Word Christian Academy,  
 Inc., Ft. Lauderdale, FL  
 Region Three School-to-Work Alliance,  
 Lima, OH  
 Rhema Outreach Ministries, Inc.,  
 Harleysville, PA  
 Richmond Conservative Union,  
 Richmond, VA  
 Riggers Athletic Club, Honolulu, HI  
 Roberson Economic Development, Inc.,  
 Pembroke Pines, FL  
 Rocky Mountain Forestry and Fire  
 Suppression, Littleton, CO  
 Roswell Outdoor Theatrical Association,  
 Inc., Roswell, NM  
 RX2000 Foundation, Minnetonka, MN  
 Safe House Services, Inc.,  
 Sherman Oaks, CA  
 Safer Children Agency,  
 S. Williamsport, PA  
 Safety Net Foundation, Philadelphia, PA  
 Saint Jude House, Wichita, KS  
 Samantha Foundation, Ltd.,  
 Ellicott City, MD  
 San Francisco Partnership,  
 San Francisco, CA  
 Sanctuary for the Arts, Portland, OR  
 Senior and Disabled Services of North  
 Carolina, Inc., Red Springs, NC  
 Seven Oaks Tenant Association,  
 Kansas City, MO  
 Shabbat New York, Inc., New York, NY  
 Shadowbrook Animal Rescue,  
 Louisville, KY  
 Shamrock Gym of Cincinnati, Inc.,  
 Loveland, OH  
 Shelter Eldercare Foundation, Inc.,  
 Baltimore, MD  
 Shepherds Learning Centers a Charitable  
 Foundation, Loomis, CA  
 Shiloh Entrepreneurial & Economic  
 Development Corp., Plainfield, NJ  
 Sistahs in Good Company,  
 Cedar Rapids, IA  
 Slavic Support and Assistance  
 Association, W. Sacramento, CA  
 Society of Hearing-Impaired Physicians,  
 Inc., Ambler, PA  
 South Bend Firefighters Association,  
 Jacksonville, AR  
 South Central Oregon Domestic Violence  
 Coalition Haven House, La Pine, OR  
 Southern New Orleans Association of the  
 Deaf, New Orleans, LA  
 Sport Psychiatry Foundation, Inc.,  
 Pacific Palisades, CA  
 St. Mathews Community Development  
 and Management Corporation,  
 Baltimore, MD  
 Star Toys Museum, Inc., Linthicum, MD  
 Supervise Family Interaction Center, Inc.,  
 Grand Blanc, MI  
 Suspicious Cheeselords, Inc.,  
 Washington, DC  
 Teen Challenge International Madison  
 Life Center, Inc., Madison, WI  
 Terrace Poe Tennen Council, Inc.,  
 Baltimore, MD  
 Tomorrows Hope, Inc., Jefferson, WI  
 Touched By a Paw, Whitewater, WI  
 Transitional Support Services,  
 Ft. Washington, MD  
 Travesties Project, Ltd., Madison, WI  
 Tri-Quest Charities, Inc., La Crosse, WI  
 Trivisions, Inc., New Carrollton, MD  
 Tropic Org Association For Resources &  
 Tropical America, Washington, DC  
 U S-Taiwan Business Forum,  
 Arlington, VA  
 Unique Rescue Base, Ferndale, MI  
 United Neighbors Involved in Quality  
 Urban Exp Unique Development, Inc.,  
 Washington, DC  
 United States Chechen Republic Alliance,  
 Inc., Silver Spring, MD  
 Unity Project, Inc., Annapolis, MD  
 Vantage Point Forum, Inc.,  
 Colorado Springs, CO  
 Via Dolorosa Genesis Project, Detroit, MI  
 Victims Impact Video, Inc.,  
 Owings Mills, MD  
 Viola Club of MD-DC & VA, Inc.,  
 Baltimore, MD  
 Wallace Development Corporation, Inc.,  
 Riviera Beach, FL  
 Walter Graham Society, Inc., Dayton, OH  
 Warrington House, Inc., Brooklyn, ME  
 Way Out Foundation, Torrance, CA  
 Waynesville Athletic Facilities  
 Committee, Inc., Waynesville, OH  
 We Care Foundation, Inc., Cincinnati, OH  
 Wellness Foundation of San Ramon  
 Valley, San Ramon, CA  
 West Hertel Academy Parent Association,  
 Buffalo, NY  
 White Bear Lake High School Wrestling  
 Booster Club, White Bear Lake, MN  
 Whitehall Day Care Center, Inc.,  
 Whitehall, WI  
 Wiconi Teca, Interior, SD  
 Wildtalk, Williams Bay, WI  
 Willie Mae Webb Home For Unwed  
 Mothers, Inc., Minneapolis, MN  
 Wings For Kids, Inc., Mechanicsburg, PA  
 Winnemucca Soccer Club,  
 Winnemucca, NV  
 Wisconsin Black Law Alumni Association  
 Corp., Madison, WI  
 Wisconsin Braille, Cazenovia, WI  
 Wisconsin Deaf Sports Club, Inc.,  
 Sun Prairie, WI  
 Wisconsin Education Reform Foundation,  
 Madison, WI  
 Wisconsin Futurity Horse Festival,  
 Pewaukee, WI  
 Wisconsin Handgun Violence Prevention,  
 Milwaukee, WI  
 Wisconsin Multisport, Inc., Madison, WI  
 Wisconsin National Organization  
 For Women Education Fund, Inc.,  
 Madison, WI  
 Wisconsin North Youth Ballet State  
 Regional Arts Center, Eau Claire, WI  
 Wisconsin Siberian Husky Rescue,  
 Madison, WI  
 Wisconsin State Youth Baseball League,  
 Inc., Milwaukee, WI  
 With Him, Inc., Oak Ridge, TN  
 Women of God, Walker, MN  
 Y O C A, Inc., Toledo, OH  
 Young Artisans Research & Design  
 Center, Inc., Pittsburgh, PA  
 Young Singers of Darlington, Inc.,  
 Darlington, SC  
 Youth Determined to Succeed, Inc.,  
 Pittsburgh, PA  
 Youth Education Scholarship Services,  
 Lathrop, CA  
 Youth Owning Urban Responsibilities  
 Service, Minneapolis, MN  
 Yukla27, Lakewood, CO  
 Yuma Family YMCA Foundation,  
 Yuma, AZ  
 Zoelife Ministries, Incorporated,  
 Baton Rouge, LA

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 clas-

sification of foundation status in the Internal Revenue Bulletin.

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## **IRS Announces Changes to Publication 1542, *Per Diem Rates (For Travel Within the Continental United States)***

### **Announcement 2004-20**

Paper copies of the February 2004 annual revision of Publication 1542 are now available. This is the last regularly scheduled printed edition. All future revisions will be available on the IRS website at [www.irs.gov](http://www.irs.gov). Paper copies will be available by request only.

Beginning this year, interim revisions to Publication 1542 will be made each time changes to *per diem* rates are announced by the General Services Administration (GSA). A *What's Hot* article on the IRS website will announce the availability of each new revision on the Internet.

The annual issue with the fiscal year *per diem* rates will be released on the Internet as soon as possible after GSA and the IRS announce those rates. We anticipate the annual issue being available in mid- to late-October.

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## **New Revision of Publication 538, *Accounting Periods and Methods***

### **Announcement 2004-21**

Publication 538, revised March 2004, is now available from the Internal Revenue

Service. It replaces the March 2003 revision.

This publication provides information on how to determine the appropriate accounting period and accounting method for your business. It also provides information on how to change your accounting period and accounting method.

You can get a copy of this publication by calling 1-800-TAX-FORM (1-800-829-3676) or by writing to the IRS Forms Distribution Center nearest you. Check your income tax package for the address. The publication is also available on the IRS Internet website at [www.irs.gov](http://www.irs.gov).

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## **Deletions From Cumulative List of Organizations Contributions to Which are Deductible Under Section 170 of the Code**

### **Announcement 2004-23**

The name of an organization that no longer qualifies as an organization described in section 170(c)(2) of the Internal Revenue Code of 1986 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under

section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on October 28, 2002, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1). For individual contributors, the maximum deduction protected is \$1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Foundation to Save Our  
Children's Environment  
Tulsa, OK

# 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 laws 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 a 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.—Statement 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.

## Numerical Finding List<sup>1</sup>

Bulletins 2004–1 through 2004–13

### Announcements:

2004-1, 2004-1 I.R.B. 254  
2004-2, 2004-3 I.R.B. 322  
2004-3, 2004-2 I.R.B. 294  
2004-4, 2004-4 I.R.B. 357  
2004-5, 2004-4 I.R.B. 362  
2004-6, 2004-3 I.R.B. 322  
2004-7, 2004-4 I.R.B. 365  
2004-8, 2004-6 I.R.B. 441  
2004-9, 2004-6 I.R.B. 441  
2004-10, 2004-7 I.R.B. 501  
2004-11, 2004-10 I.R.B. 581  
2004-12, 2004-9 I.R.B. 541  
2004-13, 2004-9 I.R.B. 543  
2004-14, 2004-10 I.R.B. 582  
2004-15, 2004-11 I.R.B. 612  
2004-16, 2004-13 I.R.B. 668  
2004-17, 2004-12 I.R.B. 635  
2004-18, 2004-12 I.R.B. 639  
2004-19, 2004-13 I.R.B. 668  
2004-20, 2004-13 I.R.B. 673  
2004-21, 2004-13 I.R.B. 673  
2004-23, 2004-13 I.R.B. 673

### Notices:

2004-1, 2004-2 I.R.B. 268  
2004-2, 2004-2 I.R.B. 269  
2004-3, 2004-5 I.R.B. 391  
2004-4, 2004-2 I.R.B. 273  
2004-5, 2004-7 I.R.B. 489  
2004-6, 2004-3 I.R.B. 308  
2004-7, 2004-3 I.R.B. 310  
2004-8, 2004-4 I.R.B. 333  
2004-9, 2004-4 I.R.B. 334  
2004-10, 2004-6 I.R.B. 433  
2004-11, 2004-6 I.R.B. 434  
2004-12, 2004-10 I.R.B. 556  
2004-13, 2004-12 I.R.B. 631  
2004-14, 2004-9 I.R.B. 526  
2004-15, 2004-9 I.R.B. 526  
2004-16, 2004-9 I.R.B. 527  
2004-17, 2004-11 I.R.B. 605  
2004-18, 2004-11 I.R.B. 605  
2004-19, 2004-11 I.R.B. 606  
2004-20, 2004-11 I.R.B. 608  
2004-21, 2004-11 I.R.B. 609  
2004-22, 2004-12 I.R.B. 632  
2004-24, 2004-13 I.R.B. 642

### Proposed Regulations:

REG-116664-01, 2004-3 I.R.B. 319  
REG-122379-02, 2004-5 I.R.B. 392

### Proposed Regulations— Continued:

REG-139845-02, 2004-5 I.R.B. 397  
REG-165579-02, 2004-13 I.R.B. 651  
REG-166012-02, 2004-13 I.R.B. 655  
REG-126459-03, 2004-6 I.R.B. 437  
REG-126967-03, 2004-10 I.R.B. 566  
REG-156232-03, 2004-5 I.R.B. 399  
REG-156421-03, 2004-10 I.R.B. 571  
REG-167217-03, 2004-9 I.R.B. 540

### Revenue Procedures:

2004-1, 2004-1 I.R.B. 1  
2004-2, 2004-1 I.R.B. 83  
2004-3, 2004-1 I.R.B. 114  
2004-4, 2004-1 I.R.B. 125  
2004-5, 2004-1 I.R.B. 167  
2004-6, 2004-1 I.R.B. 197  
2004-7, 2004-1 I.R.B. 237  
2004-8, 2004-1 I.R.B. 240  
2004-9, 2004-2 I.R.B. 275  
2004-10, 2004-2 I.R.B. 288  
2004-11, 2004-3 I.R.B. 311  
2004-12, 2004-9 I.R.B. 528  
2004-13, 2004-4 I.R.B. 335  
2004-14, 2004-7 I.R.B. 489  
2004-15, 2004-7 I.R.B. 490  
2004-16, 2004-10 I.R.B. 559  
2004-17, 2004-10 I.R.B. 562  
2004-18, 2004-9 I.R.B. 529  
2004-19, 2004-10 I.R.B. 563  
2004-20, 2004-13 I.R.B. 642

### Revenue Rulings:

2004-1, 2004-4 I.R.B. 325  
2004-2, 2004-2 I.R.B. 265  
2004-3, 2004-7 I.R.B. 486  
2004-4, 2004-6 I.R.B. 414  
2004-5, 2004-3 I.R.B. 295  
2004-6, 2004-4 I.R.B. 328  
2004-7, 2004-4 I.R.B. 327  
2004-8, 2004-10 I.R.B. 544  
2004-9, 2004-6 I.R.B. 428  
2004-10, 2004-7 I.R.B. 484  
2004-11, 2004-7 I.R.B. 480  
2004-12, 2004-7 I.R.B. 478  
2004-13, 2004-7 I.R.B. 485  
2004-14, 2004-8 I.R.B. 511  
2004-15, 2004-8 I.R.B. 515  
2004-16, 2004-8 I.R.B. 503  
2004-17, 2004-8 I.R.B. 516  
2004-18, 2004-8 I.R.B. 509  
2004-19, 2004-8 I.R.B. 510  
2004-20, 2004-10 I.R.B. 546  
2004-21, 2004-10 I.R.B. 544  
2004-22, 2004-10 I.R.B. 553  
2004-23, 2004-11 I.R.B. 585

### Revenue Rulings— Continued:

2004-24, 2004-10 I.R.B. 550  
2004-25, 2004-11 I.R.B. 587  
2004-26, 2004-11 I.R.B. 598  
2004-27, 2004-12 I.R.B. 625  
2004-28, 2004-12 I.R.B. 624  
2004-29, 2004-12 I.R.B. 627  
2004-30, 2004-12 I.R.B. 622  
2004-31, 2004-12 I.R.B. 617  
2004-32, 2004-12 I.R.B. 621  
2004-33, 2004-12 I.R.B. 628  
2004-34, 2004-12 I.R.B. 619  
2004-35, 2004-13 I.R.B. 640  
2004-36, 2004-12 I.R.B. 620  
2004-37, 2004-11 I.R.B. 583

### Tax Conventions:

2004-3, 2004-7 I.R.B. 486

### Treasury Decisions:

9099, 2004-2 I.R.B. 255  
9100, 2004-3 I.R.B. 297  
9101, 2004-5 I.R.B. 376  
9102, 2004-5 I.R.B. 366  
9103, 2004-3 I.R.B. 306  
9104, 2004-6 I.R.B. 406  
9105, 2004-6 I.R.B. 419  
9106, 2004-5 I.R.B. 384  
9107, 2004-7 I.R.B. 447  
9108, 2004-6 I.R.B. 429  
9109, 2004-8 I.R.B. 519  
9110, 2004-8 I.R.B. 504  
9111, 2004-8 I.R.B. 518  
9112, 2004-9 I.R.B. 523  
9113, 2004-9 I.R.B. 524  
9114, 2004-11 I.R.B. 589

<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

## Findings List of Current Actions on Previously Published Items<sup>1</sup>

Bulletins 2004–1 through 2004–13

### Announcements:

#### 2003-56

Modified by

Ann. 2004-11, 2004-10 I.R.B. 581

### Notices:

#### 98-5

Withdrawn by

Notice 2004-19, 2004-11 I.R.B. 606

#### 2003-76

Modified by

Notice 2004-19, 2004-11 I.R.B. 606

### Proposed Regulations:

#### REG-110896-98

Corrected by

Ann. 2004-14, 2004-10 I.R.B. 582

#### REG-115037-00

Corrected by

Ann. 2004-7, 2004-4 I.R.B. 365

#### REG-143321-02

Withdrawn by

REG-156232-03, 2004-5 I.R.B. 399

#### REG-146893-02

Corrected by

Ann. 2004-7, 2004-4 I.R.B. 365

#### REG-163974-02

Corrected by

Ann. 2004-13, 2004-9 I.R.B. 543

### Revenue Procedures:

#### 87-19

Obsoleted in part by

Rev. Proc. 2004-18, 2004-9 I.R.B. 529

#### 93-15

Obsoleted in part by

Rev. Proc. 2004-18, 2004-9 I.R.B. 529

#### 94-41

Superseded by

Rev. Proc. 2004-15, 2004-7 I.R.B. 490

#### 94-55

Obsoleted in part by

Rev. Proc. 2004-18, 2004-9 I.R.B. 529

#### 98-16

Suspended by

Notice 2004-12, 2004-10 I.R.B. 556

### Revenue Procedures— Continued:

#### 2000-38

Modified by

Rev. Proc. 2004-11, 2004-3 I.R.B. 311

#### 2000-50

Modified by

Rev. Proc. 2004-11, 2004-3 I.R.B. 311

#### 2001-10

Modified by

Ann. 2004-16, 2004-13 I.R.B. 668

#### 2001-23

Modified by

Ann. 2004-16, 2004-13 I.R.B. 668

#### 2002-9

Modified and amplified by

Rev. Rul. 2004-18, 2004-8 I.R.B. 509

Modified by

Rev. Proc. 2004-11, 2004-3 I.R.B. 311

Ann. 2004-16, 2004-13 I.R.B. 668

#### 2002-28

Modified by

Ann. 2004-16, 2004-13 I.R.B. 668

#### 2002-71

Superseded by

Rev. Proc. 2004-13, 2004-4 I.R.B. 335

#### 2003-1

Superseded by

Rev. Proc. 2004-1, 2004-1 I.R.B. 1

#### 2003-2

Superseded by

Rev. Proc. 2004-2, 2004-1 I.R.B. 83

#### 2003-3

As amplified by Rev. Proc. 2003-14, and as modified by Rev. Proc. 2003-48 superseded by

Rev. Proc. 2004-3, 2004-1 I.R.B. 114

#### 2003-4

Superseded by

Rev. Proc. 2004-4, 2004-1 I.R.B. 125

#### 2003-5

Superseded by

Rev. Proc. 2004-5, 2004-1 I.R.B. 167

#### 2003-6

Superseded by

Rev. Proc. 2004-6, 2004-1 I.R.B. 197

#### 2003-7

Superseded by

Rev. Proc. 2004-7, 2004-1 I.R.B. 237

#### 2003-8

Superseded by

Rev. Proc. 2004-8, 2004-1 I.R.B. 240

### Revenue Procedures— Continued:

#### 2003-23

Modified and superseded by

Rev. Proc. 2004-14, 2004-7 I.R.B. 489

#### 2003-26

Supplemented by

Rev. Proc. 2004-17, 2004-10 I.R.B. 562

#### 2004-1

Corrected by

Ann. 2004-8, 2004-6 I.R.B. 441

#### 2004-4

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. 490

#### 2004-5

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. 490

#### 2004-6

Modified by

Rev. Proc. 2004-15, 2004-7 I.R.B. 490

### Revenue Rulings:

#### 55-748

Modified and superseded by

Rev. Rul. 2004-20, 2004-10 I.R.B. 546

#### 92-19

Supplemented in part by

Rev. Rul. 2004-14, 2004-8 I.R.B. 511

#### 94-38

Clarified by

Rev. Rul. 2004-18, 2004-8 I.R.B. 509

#### 98-25

Clarified by

Rev. Rul. 2004-18, 2004-8 I.R.B. 509

<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

# INDEX

## Internal Revenue Bulletins 2004–1 through 2004–13

The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parentheses refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears.

### Key to Abbreviations:

Ann	Announcement
CD	Court Decision
DO	Delegation Order
EO	Executive Order
PL	Public Law
PTE	Prohibited Transaction Exemption
RP	Revenue Procedure
RR	Revenue Ruling
SPR	Statement of Procedural Rules
TC	Tax Convention
TD	Treasury Decision
TDO	Treasury Department Order

## EMPLOYEE PLANS

COBRA health care continuation coverage requirements (RR 22) 10, 553  
Determination letters, issuing procedures (RP 6) 1, 197  
Electronic delivery of payee statements (Notice 10) 6, 433  
Forms 1099 and 5498 payee statements, electronic delivery (Notice 10) 6, 433  
Full funding limitations, weighted average interest rate for:  
January 2004 (Notice 3) 5, 391  
February 2004 (Notice 14) 9, 526  
March 2004 (Notice 24) 13, 642  
Letter rulings:  
And determination letters, areas which will not be issued from:  
Associates Chief Counsel and Division Counsel (TE/GE) (RP 3) 1, 114  
Associate Chief Counsel (International) (RP 7) 1, 237  
And information letters, etc. (RP 4) 1, 125  
And information letters issued by Associate Offices, determination letters issued by Operating Divisions (RP 1) 1, 1; correction of user fee (Ann 8) 6, 441

## EMPLOYEE PLANS—Cont.

User fees, request for letter rulings (RP 8) 1, 240  
Minimum funding standards, waivers (RP 15) 7, 490  
Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335  
Proposed Regulations:  
26 CFR 1.79–1, amended; 1.83–3, amended; 1.402(a)–1, amended; value of life insurance contracts when distributed from a qualified retirement plan (REG–126967–03) 10, 566  
Qualified retirement plans:  
Employee stock ownership plans, synthetic equity, listed transactions (RR 4) 6, 414  
Minimum participation standards, special rule (RR 11) 7, 480  
Rollovers (RR 12) 7, 478  
Section 412(i) plans:  
Deductibility, listed transactions (RR 20) 10, 546  
Discrimination (RR 21) 10, 544  
Valuation (RP 16) 10, 559  
Top-heavy status, special rules (RR 13) 7, 485  
Vesting, consent (RR 10) 7, 484  
Roth IRAs, tax shelters (Notice 8) 4, 333  
S corporations, employee stock ownership plans (ESOPs), termination of election (RP 14) 7, 489  
Technical advice:  
To directors and appeals area directors from Associates Chief Counsel and Division Counsel/Associate Chief Counsel (TE/GE) (RP 2) 1, 83  
To IRS employees (RP 5) 1, 167  
Valuation of distributed life insurance contracts (REG–126967–03) 10, 566

## EMPLOYMENT TAX

Delinquent tax, levy on wages, salary, and other income, exempt amount tables (Notice 4) 2, 273  
Form W-2, new reporting code for Box 12, 2004 (Ann 2) 3, 322  
Income and employment tax treatment of benefits received under the Smallpox Emergency Personnel Protection Act of 2003 (SEPPA) (Notice 17) 11, 605

## EMPLOYMENT TAX—Cont.

Mileage allowance, local transportation expenses computed similarly to a courier's compensation, accountable plan (RR 1) 4, 325  
Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335  
Proposed Regulations:  
26 CFR 31.3121(b)(2)–1, amended; 31.3121(b)(10)–2, amended; 31.3306(c)(10)–2, revised; student FICA exception (REG–156421–03) 10, 571  
Reduction of the stated principal amount of a recourse note issued by the employee to the employer to acquire employer stock, treatment (RR 37) 11, 583  
Student FICA exception under Code section 3121(b)(10):  
And section 3306(c)(10)(B), application (REG–156421–03) 10, 571  
Proposed safe harbor available for certain institutions (Notice 12) 10, 556

## ESTATE TAX

Gross estate, election to value on alternate valuation date (REG–139845–02) 5, 397  
Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335  
Proposed Regulations:  
26 CFR 20.2032–1(b), revised; 301.9100–6T, amended; gross estate, election to value on alternate valuation date (REG–139845–02) 5, 397  
Regulations:  
26 CFR 20.2056(b), amended; 20.2056A–5, amended; 20.2056A–13, revised; definition of income for trust purposes (TD 9102) 5, 366  
Trusts, definition of income, total return, adjustments to income (TD 9102) 5, 366

## EXCISE TAX

Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335

## EXEMPT ORGANIZATIONS

- Declaratory judgment suits, annual notice to donors regarding pending and settled suits (Ann 1) 1, 254
- Electronic delivery of payee statements (Notice 10) 6, 433
- Forms 1099 and 5498 payee statements, electronic delivery (Notice 10) 6, 433
- Letter rulings:
  - And determination letters, areas which will not be issued from Associates Chief Counsel and Division Counsel (TE/GE) (RP 3) 1, 114
  - And information letters, etc. (RP 4) 1, 125
  - And information letters issued by Associate Offices, determination letters issued by Operating Divisions (RP 1) 1, 1; correction of user fee (Ann 8) 6, 441
  - User fees, request for letter rulings (RP 8) 1, 240
- List of organizations classified as private foundations (Ann 12) 9, 541; (Ann 15) 11, 612; (Ann 17) 12, 635; (Ann 19) 13, 668
- Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335
- Public advocacy activities conducted by certain tax-exempt organizations (RR 6) 4, 328
- Revocations (Ann 18) 12, 639; (Ann 23) 13, 673
- Technical advice:
  - To directors and appeals area directors from Associates Chief Counsel and Division Counsel/Associate Chief Counsel (TE/GE) (RP 2) 1, 83
  - To IRS employees (RP 5) 1, 167

## GIFT TAX

- Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335
- Regulations:
  - 26 CFR 25.2523(e)-1, amended; 25.2523(h)-2, amended; 26.2601-1, amended; definition of income for trust purposes (TD 9102) 5, 366
- Trusts, definition of income, total return, adjustments to income (TD 9102) 5, 366

## INCOME TAX

- Abusive foreign tax credit transactions:
  - Taxpayer alert (Notice 20) 11, 608
  - Withdrawal of Notice 98-5 (Notice 19) 11, 606
- Agent for certain purposes, definition (TD 9111) 8, 518
- Automobile owners and lessees, inflation adjustment for 2004 (RP 20) 13, 642
- Capitalization:
  - Of amounts paid to acquire or create intangibles (TD 9107) 7, 447
  - Tangible property (Notice 6) 3, 308
- Capitalized costs, treatment of capitalized business acquisition costs (Notice 18) 11, 605
- Charitable contributions, intellectual property (Notice 7) 3, 310
- Charitable remainder trust, application of ordering rule, cancellation of public hearing on REG-110896-98 (Ann 14) 10, 582
- Confidential transactions (TD 9108) 6, 429
- Contingent nonperiodic payments made pursuant to notional principal contracts (REG-166012-02) 13, 655
- Corporations:
  - Spin-offs, corporate distributions (RR 23) 11, 585
  - Transfers of assets or stock following a reorganization (REG-165579-02) 13, 651
- Cost depletion for an oil and gas property, determining total recoverable units to compute (RP 19) 10, 563
- Credits:
  - Health coverage tax credit, qualified health insurance (RP 12) 9, 528
  - Increasing research activities credit:
    - Internal-use software, advance notice of proposed rulemaking - REG-153656-03 (Ann 9) 6, 441
  - Qualified research definition (TD 9104) 6, 406
  - Research credit recordkeeping agreements, pilot program (Notice 11) 6, 434
- Low-income housing credit:
  - 2004 population figures used for calculation (Notice 21) 11, 609
  - Satisfactory bond, "bond factor" amounts for the period:
    - January through March 2004 (RR 16) 8, 508
  - State or local housing tax credit (TD 9110) 8, 503

## INCOME TAX—Cont.

- Declaratory judgment suits, annual notice to donors regarding pending and settled suits (Ann 1) 1, 254
- Disciplinary actions involving attorneys, certified public accountants, enrolled agents, and enrolled actuaries (Ann 6) 3, 499
- Disclosure of relative values of optional forms of benefit (TD 9099) 2, 255
- Electronic filing of:
  - Certain income tax returns and other forms (TD 9100) 3, 297; (REG-116664-01) 3, 319
  - Duplicate Forms 5472 (TD 9113) 9, 524; (REG-167217-03) 9, 540
  - Form 8609 (TD 9112) 9, 523
- Electronic payee statements (TD 9114) 11, 589
- Environmental remediation expenses:
  - Restoration of amount held under claim of right (RR 17) 8, 516
  - Uniform capitalization of costs (RR 18) 8, 509
- Forest Land Enhancement Program (FLEP), cost-share payments (RR 8) 10, 544
- Forms:
  - 3115, Application for Change in Accounting Method, revised (Ann 16) 13, 668
  - 5472, electronic filing of duplicates (TD 9113) 9, 524; (REG-167217-03) 9, 540
  - 8609, Low-Income Housing Credit Allocation Certification, electronic filing (TD 9112) 9, 523
  - 8806, Information Return for Acquisition of Control or Substantial Change in Capital Structure, new (Ann 5) 4, 361
  - 8858, Information Return of U.S. Persons With Respect to Foreign Disregarded Entities, comments requested (Ann 4) 4, 357
- Frivolous tax returns:
  - Attempting to avoid taxes under section 861 (RR 30) 12, 622
  - Common tax avoidance schemes, civil and criminal penalties (Notice 22) 12, 632
  - Excluding gross income under section 911 (RR 28) 12, 624
  - Filing a "zero return" (RR 34) 12, 619
  - Meritless "claim of right" arguments (RR 29) 12, 627

## INCOME TAX—Cont.

Meritless “corporation sole” argument (RR 27) 12, 625

Meritless home-based business deductions (RR 32) 12, 621

Meritless “removal arguments” (RR 31) 12, 617

Reparations tax credit (RR 33) 12, 628

Health Savings Accounts (HSAs), questions and answers (Notice 2) 2, 269

Income and employment tax treatment of benefits received under the Smallpox Emergency Personnel Protection Act of 2003 (SEPPA) (Notice 17) 11, 605

Individual income tax returns, common taxpayer mistakes (Notice 13) 12, 631

Individual Taxpayer Identification Numbers (ITINs), new application process (Notice 1) 2, 268

Information reporting:

- Extension of certain 2004 deadlines (Notice 9) 4, 334
- For payments in lieu of dividends (TD 9103) 3, 306
- Health plans (Notice 16) 9, 527

Insurance companies:

- Distributions from non-qualified annuity, section 72(q)(2) (Notice 15) 9, 526
- Diversification requirements for variable annuity, endowment, and life insurance contracts (REG-163974-02), hearing (Ann 13) 9, 543
- Loss payment patterns and discount factors for the 2003 accident year (RP 9) 2, 275
- Salvage discount factors for the 2003 accident year (RP 10) 2, 288

Interest:

Investment:

- Federal short-term, mid-term, and long-term rates for:
  - January 2004 (RR 2) 2, 265
  - February 2004 (RR 9) 6, 428
  - March 2004 (RR 25) 11, 587
- Rate tables (RR 14) 8, 512

Rates:

- Underpayments and overpayments, quarter beginning:
  - April 1, 2004 (RR 26) 11, 598

Inventory:

- LIFO, price indexes used by department stores for:
  - November 2003 (RR 7) 4, 327
  - December 2003 (RR 19) 8, 511
  - January 2004 (RR 35) 13, 640

## INCOME TAX—Cont.

Letter rulings:

- And determination letters, areas which will not be issued from:
  - Associates Chief Counsel and Division Counsel (TE/GE) (RP 3) 1, 114
  - Associate Chief Counsel (International) (RP 7) 1, 237
- And information letters issued by Associate Offices, determination letters issued by Operating Divisions (RP 1) 1, 1; correction of user fee (Ann 8) 6, 441

Methods of accounting, changes in determining depreciation or amortization (RP 11) 3, 311; (TD 9105) 6, 419; (REG-126459-03) 6, 437

Partnerships:

- Charitable contributions, trust governing instrument requirement (RR 5) 3, 295
- Electing large partnerships, separately stated items, qualified dividend income (Notice 5) 7, 489

Penalties, defenses available to the imposition of the accuracy-related penalty (TD 9109) 8, 519

Per diem rates, Publication 1542, revision changes (Ann 20) 13, 673

Practice before the Internal Revenue Service (REG-122379-02) 5, 392

Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335

Private foundations, organizations now classified as (Ann 12) 9, 541; (Ann 15) 11, 612; (Ann 17) 12, 635; (Ann 19) 13, 668

Proposed Regulations:

- 26 CFR 1.162-30, added; 1.212-1(q), added; 1.446-3, amended; 1.1234A-1, added; notional principal contracts, contingent nonperiodic payments (REG-166012-02) 13, 655
- 26 CFR 1.167(e)-1, amended; 1.446-1, amended; 1.1016-3, amended; changes in computing depreciation (REG-126459-03) 6, 437
- 26 CFR 1.170A-11, amended; 1.556-2, amended; 1.565-1, amended; 1.936-7, amended; 1.1017-1, amended; 1.1368-1, amended; 1.1377-1, amended; 1.1502-21, -75, amended;

## INCOME TAX—Cont.

- 1.1503-2, amended; 1.6038B-1, amended; 301.7701-3, amended; guidance necessary to facilitate business electronic filing (REG-116664-01) 3, 319
- 26 CFR 1.368-1, -2, amended; corporate reorganizations, transfers of assets or stock following a reorganization (REG-165579-02) 13, 651
- 26 CFR 1.482-6, -9, amended; treatment of services under section 482, allocation of income and deductions from intangibles (REG-115037-00, REG-146893-02); correction (Ann 7) 4, 365
- 26 CFR 1.6038A-1, -2, amended; electronic filing of duplicate Forms 5472 (REG-167217-03) 9, 540
- 26 CFR 1.6043-4, added; 1.6045-3, added; information reporting relating to taxable stock transactions (REG-156232-03) 5, 399
- 31 CFR 10.33, revised; 10.35, added; 10.36, added; 10.37, added; regulations governing practice before the Internal Revenue Service (REG-122379-02) 5, 392

Publications:

- 538, Accounting Periods and Methods, revised (Ann 21) 13, 673
- 1220, Specifications for Filing Forms 1098, 1099, 5498 and W-2G Electronically or Magnetically, changes affecting tax year 2003 filing of information returns (Ann 3) 2, 294
- 1542, Per Diem Rates (For Travel Within the Continental United States), revision changes (Ann 20) 13, 673

Qualified dividends, changes to rules (Ann 11) 10, 581

Qualified mortgage bonds and mortgage credit certificates, average area and nationwide housing purchase prices (RP 18) 9, 529

Qualified offer regulations, award of attorney’s fees and other costs (TD 9106) 5, 384

Real estate investment trust (REIT) parking income (RR 24) 10, 550

Reduction of the stated principal amount of a recourse note issued by the employee to the employer to acquire employer stock, treatment (RR 37) 11, 583

## INCOME TAX—Cont.

### Regulations:

- 26 CFR 1.41-0, -4, amended; 602.101, amended; credit for increasing research activities (TD 9104) 6, 406
- 26 CFR 1.42-1, added; 1.42-1T, amended; low-income housing credit allocation certification, electronic filing (TD 9112) 9, 523
- 26 CFR 1.42-6, -8, -12, -14, amended; section 42 carryover and stacking rule amendments (TD 9110) 8, 503
- 26 CFR 1.167(a)-3, amended; 1.263(a)-0, -4, -5, added; 1.446-5, added; 602.101, amended; guidance regarding deduction and capitalization of expenditures (TD 9107) 7, 447
- 26 CFR 1.167(e)-1, amended; 1.167(e)-1T, added; 1.446-1, amended; 1.446-1T, added; 1.1016-3, amended; 1.1016-3T, added; changes in computing depreciation (TD 9105) 6, 419
- 26 CFR 1.170A-11, amended; 1.170A-11T, added; 1.556-2, amended; 1.556-2T, added; 1.565-1, amended; 1.565-1T, added; 1.936-7, amended; 1.936-7T, added; 1.1017-1, -1T, amended; 1.1368-1, amended; 1.1368-1T, added; 1.1377-1, amended; 1.1377-1T, added; 1.1502-21, -21T, -75, amended; 1.1502-75T, added; 1.1503-2, amended; 1.1503-2T, added; 1.6038B-1, -1T, amended; 301.7701-3, amended; 301.7701-3T, added; 602.101, amended; guidance necessary to facilitate business electronic filing (TD 9100) 3, 297
- 26 CFR 1.401(a)-11, -(20), revised; 1.417(a)(3)-1, added; 1.417(e)-1, amended; 602.101, amended; disclosure of relative values of optional forms of benefit (TD 9099) 2, 255
- 26 CFR 1.642(c)-2, amended; 1.642(c)-5, revised; 1.643, revised; 1.651(a)-2(d), added; 1.661(a)-2(f), revised; 1.664-3, amended; definition of income for trust purposes (TD 9102) 5, 366
- 26 CFR 1.1502-35T, amended; suspension of losses on certain stock

## INCOME TAX—Cont.

- dispositions (TD 9048); correction (Ann 10) 7, 501
- 26 CFR 1.6011-4, amended; 301.6112-1, amended; confidential transactions (TD 9108) 6, 429
- 26 CFR 1.6038A-2, amended; 1.6038-2T, added; electronic filing of duplicate Forms 5472 (TD 9113) 9, 524
- 26 CFR 1.6041-2(a)(5), added; 1.6041-2T, removed; 1.6050S-2, -4, added; 1.6050S-2T, -4T, removed; 31.6051-1(j), added; 31.6051-1T, removed; 301.6724-1T, removed; 602.101(b), amended; electronic payee statements (TD 9114) 11, 589
- 26 CFR 1.6043-4T, revised; 1.6045-3T, revised; information reporting relating to taxable stock transactions (TD 9101) 5, 376
- 26 CFR 1.6045-2, amended; information statements for certain substitute payments (TD 9103) 3, 306
- 26 CFR 1.6662-0, -2, -3, -4, amended; 1.6664-0, -1, -4, amended; establishing defenses to the imposition of the accuracy-related penalty (TD 9109) 8, 519
- 26 CFR 301.6103(1)-1, added; 301.6103(m)-1, added; definition of agent for certain purposes (TD 9111) 8, 518
- 26 CFR 301.7430-7, added; 301.7430-7T, removed; awards of attorney's fees and other costs based upon qualified offers (TD 9106) 5, 384
- Reporting an acquisition of control or substantial change in capital structure, new Form 8806 (Ann 5) 4, 362
- Revocations, exempt organizations (Ann 18) 12, 639; (Ann 23) 13, 673
- Section 911(d)(4) waiver, 2003 update (RP 17) 10, 562
- Standard Industry Fare Level (SIFL) formula (RR 36) 12, 620
- Stocks:
  - Constructive sale, short sale, and transfers by broker (RR 15) 8, 515
  - Guidance under section 1502, suspension of losses on certain stock dispositions (TD 9048); correction (Ann 10) 7, 501

## INCOME TAX—Cont.

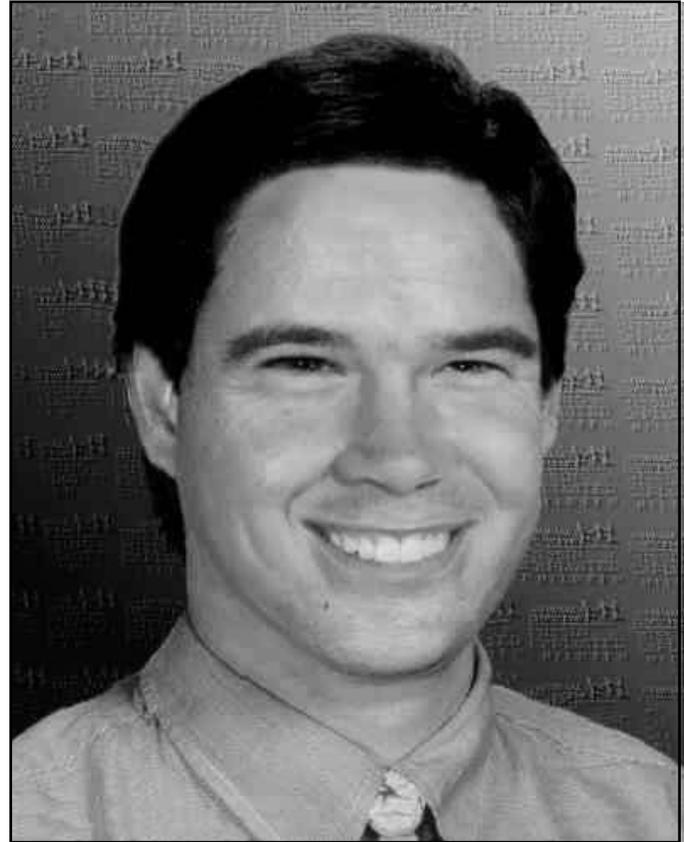
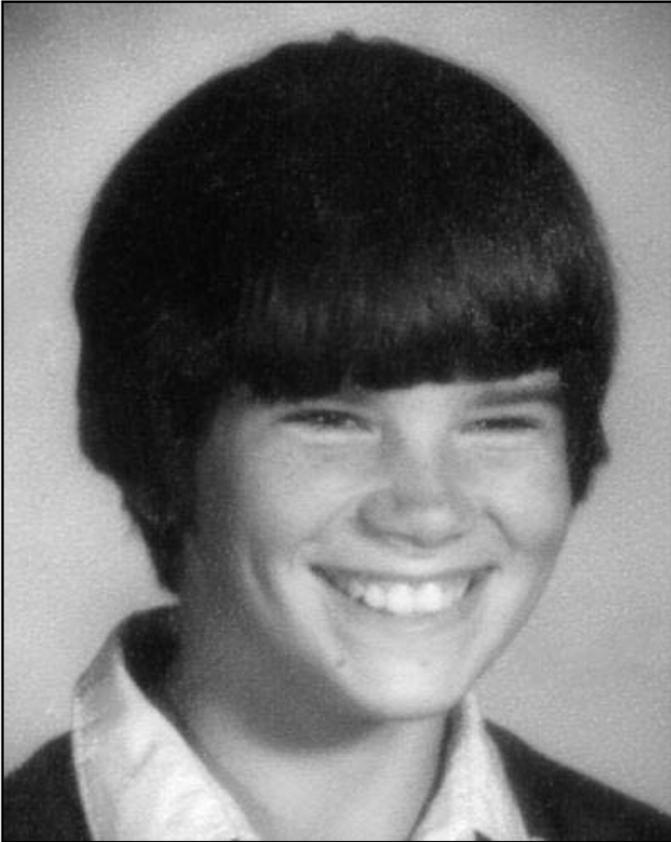
- Information reporting relating to taxable stock transactions (TD 9101) 5, 376; (REG-156232-03) 5, 399
- Tax conventions, taxation of nonresident partners in a service partnership that conducts activities in the United States (RR 3) 7, 486
- Technical advice to directors and appeals area directors from Associates Chief Counsel and Division Counsel/Associate Chief Counsel (TE/GE) (RP 2) 1, 83
- Treatment of services under section 482 (REG-115037-00, REG-146893-02); correction (Ann 7) 4, 365
- Trusts, definition of income, total return, adjustments to income (TD 9102) 5, 366

## SELF-EMPLOYMENT TAX

- Presidentially-declared disaster or combat zone, postponement of certain acts (RP 13) 4, 335

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