

## **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. 2002-23, page 812.**

The Service will accept, as timely filed, a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service that is mailed from and officially postmarked in a foreign country on or before the last date prescribed for filing, including any extension of time for filing. This ruling also sets forth the position that a federal return, claim for refund, statement, or other document required or permitted to be filed with the Service or with the United States Tax Court given to a designated international private delivery service before midnight on the last date prescribed for filing shall be deemed timely filed pursuant to section 7502 of the Code. Rev. Rul. 80-218 superseded.

#### **Rev. Proc. 2002-28, page 815.**

**Methods of accounting; inventories; small business taxpayers.** This procedure provides that the Commissioner will exercise his discretion to except qualifying small business taxpayers from the requirements to use an accrual method of accounting under section 446 of the Code and to account for inventories under section 471 of the Code. Rev. Proc. 2002-9 modified and amplified. Notice 2002-14 modified and superseded.

### **EMPLOYEE PLANS**

#### **Notice 2002-27, page 814.**

**Minimum distributions; reporting requirements.** This notice provides guidance on the reporting required from issuers, custodians, and trustees with respect to required minimum distributions from individual retirement arrangements (IRAs).

#### **Announcement 2002-46, page 834.**

**Safe harbor explanation (in Spanish); certain qualified plan distributions.** This announcement repeats, in Spanish, the safe harbor explanation to employees portion of Notice 2002-3 (2002-2 I.R.B. 289) that plan administrators may use for recipients of eligible rollover distributions in order to satisfy section 402(f) of the Code.

### **EXEMPT ORGANIZATIONS**

#### **Announcement 2002-47, page 844.**

This document solicits comments addressing whether several regulations under Chapter 42 should be revised, with respect to excise taxes imposed on foundation and organization managers, to conform to recently-issued final regulations under section 4958 of the Code. This announcement also solicits comments addressing any other areas of Chapter 42 regulations that may need updating.

#### **Announcement 2002-50, page 845.**

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

Finding Lists begin on page ii.  
Index for January through April begins on page v.

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## EXCISE TAX

### **Announcement 2002-47, page 844.**

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## ADMINISTRATIVE

### **REG-104762-00, page 825.**

Proposed regulations under section 6331 of the Code provide for the prohibition of levy while an installment agreement is pending with the Secretary, while an installment agreement is in effect, and following the rejection or termination of an installment agreement. The regulations clarify when levy is prohibited and the effect of that prohibition on the statute of limitations for collection. They also provide that the IRS may not commence a proceeding in court for the collection of a tax included in a proposed or active installment agreement while levy is prohibited by this section.

### **REG-105369-00, page 828.**

Proposed regulations under sections 148 and 141 of the Code provide guidance on the definitions of investment-type property and private loan for the arbitrage and private activity restrictions applicable to tax-exempt bonds issued by state and local governments. A public hearing is scheduled for September 24, 2002. REG-113526-98 withdrawn.

### **Announcement 2002-45, page 833.**

**Methods of accounting; small business taxpayers.** This announcement discusses some of the most significant issues raised in comments received in response to Notice 2001-76 (2001-52 I.R.B. 613). The notice proposed procedures under which qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less would be excepted from the requirements to use an accrual method of accounting under section 446 of the Code and to account for inventories under section 471 of the Code for eligible businesses.

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

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

## Section 162.—Trade or Business Expenses

*26 CFR 1.162-1: Cost of materials.*

Qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less are excepted from the requirement to account for inventories under § 471 for eligible trades or businesses, but may account for inventoriable items as materials and supplies that are not incidental under § 1.162-3. See Rev. Proc. 2002-28, page 815.

## Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

*26 CFR 1.263A-1: Uniform capitalization of costs.*

For eligible trades or businesses, inventoriable items of qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less are not subject to § 263A, but may be treated as materials and supplies that are not incidental under § 1.162-3. See Rev. Proc. 2002-28, page 815.

## Section 446.—General Rule for Methods of Accounting

*26 CFR 1.446-1: General rule for methods of accounting.*

Qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less are excepted from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471 for eligible trades or businesses. See Rev. Proc. 2002-28, page 815.

## Section 447.—Method of Accounting for Corporations Engaged in Farming

Taxpayers that are required to use the accrual method of accounting under § 447 are not “qualifying small business taxpayers” that are excepted from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471. See Rev. Proc. 2002-28, page 815.

## Section 448.—Limitation on Use of Cash Method of Accounting

*26 CFR 1.448-1T: Limitations on the use of the cash receipts and disbursements method of accounting.*

Taxpayers that are required to use the accrual method of accounting under § 448 are not “qualifying small business taxpayers” that are excepted from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471. See Rev. Proc. 2002-28, page 815.

## Section 460.—Special Rules for Long-Term Contracts

*26 CFR 1.460-1: Long-term contracts.*

Under § 460, qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less that are excepted from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471 for eligible trades or businesses may be required to account for certain items using a long-term contract method. See Rev. Proc. 2002-28, page 815.

## Section 471.—General Rule for Inventories

*26 CFR 1.471-1: Need for inventories.*

Qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less are excepted from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471 for eligible trades or businesses, and may account for inventoriable items as materials and supplies that are not incidental under § 1.162-3. See Rev. Proc. 2002-28, page 815.

## Section 481.—Adjustments Required for Changes in Method of Accounting

*26 CFR 1.481-1: Adjustments in general.*  
*26 CFR 1.481-4: Adjustments taken into account with consent.*

For eligible trades or businesses, qualifying small business taxpayers with average annual gross receipts of \$10,000,000 or less may obtain automatic consent to change to the cash receipts and disbursements method of accounting and to account for inventoriable items as materials and supplies that are not incidental under § 1.162-3. See Rev. Proc. 2002-28, page 815.

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

*26 CFR 1.1001-1: Computation of gain or loss.*

Notwithstanding § 1001 and the regulations thereunder, qualifying small business taxpayers that are excepted from the requirements to use an accrual method of accounting under § 446 of the Code and to account for inventories under § 471 for eligible trades or businesses will include amounts attributable to open accounts receivable (due in 120 days or less) in income as the amounts are actually or constructively received. See Rev. Proc. 2002-28, page 815.

## Section 6081.—Extension of Time for Filing Returns

## Section 7502.—Timely Mailing Treated as Timely Filing and Paying

*26 CFR § 1.6081-1(a): Extension of time for filing returns.*

*26 CFR 301.7502-1: Timely mailing treated as timely filing.*

This ruling sets forth the position that the Internal Revenue Service will accept, as timely filed, a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service that is mailed from and officially postmarked in a foreign country on or before the last date prescribed for filing,

including any extension of time for filing. The ruling also sets forth the position that a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service or with the United States Tax Court given to a designated private delivery service before midnight on the last date prescribed for filing shall be deemed timely filed pursuant to sections 7502(a), (d)(1), and (f)(1) of the Code.

## Rev. Rul. 2002-23

### ISSUES:

1. Whether the Internal Revenue Service ("Service") will accept as timely filed a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service when it is mailed from and officially postmarked in a foreign country on or before the last date prescribed for filing?

2. Whether a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service or with the United States Tax Court is timely filed when it is given to a designated delivery service in a foreign country and recorded or marked as described in section 7502(f)(2)(C) before midnight on the last date prescribed for filing?

### LAW AND ANALYSIS:

Pursuant to Rev. Rul. 80-218 (1980-2 C.B. 386), and Policy Statement P-2-9 (July 27, 1969), the Service has accepted federal tax returns mailed by taxpayers from foreign countries as timely filed if they bear an official postmark dated on or before the last date prescribed for filing, including any extension of time for such filing. If the last date for filing falls on a Saturday, Sunday, or a legal holiday within the meaning of section 7503, returns have been considered timely if postmarked on or before the next succeeding day which is not a Saturday, Sunday, or a legal holiday. This revenue ruling reaffirms the position previously announced in Rev. Rul. 80-218 and Policy Statement P-2-9. For purposes of this revenue ruling, the term legal holiday means a legal holiday in the District of

Columbia in the United States, or a State-wide legal holiday in the State where the federal tax return, claim for refund or other document is required to be filed or sent. The term does not include legal holidays in foreign countries unless such holidays are also legal holidays in the District of Columbia or applicable State, as described above.

In addition, pursuant to the authority granted by section 6081(a) of the Code, which permits the Commissioner to grant a reasonable extension of time for filing any return, declaration, statement or other document, this revenue ruling expands the application of the timely mailing is timely filing rules set forth in Rev. Rul. 80-218 to claims for refund, statements or other documents required or permitted to be filed with the Service. Accordingly, claims for refund, statements and other documents will be treated as timely filed if the conditions described above are satisfied. If, however, the envelope that contains a claim, statement or other document has a timely postmark, but it is received after the time when an envelope postmarked and mailed at that time and location would ordinarily be received, the sender may be required to prove that it was timely mailed.

Timely filing treatment, however, will not apply to foreign postmarked documents filed with the United States Tax Court, such as petitions and notices of appeal, unless given to a designated international delivery service as discussed below. *See, e.g., Sarrell v. Commissioner*, 117 T.C. 122 (2001).

Section 7502(f) authorizes the Secretary to designate delivery services satisfying the requirements of section 7502(f)(2) to deliver items qualifying for timely mailing as timely filing treatment in the same manner as items postmarked and deposited in the United States mail. Returns, claims for refund, statements and other documents sent via an international delivery service qualify for timely mailing as timely filing treatment if the international delivery service meets the requirements of section 7502(f)(2) and is designated under Rev. Proc. 97-19 (1997-1 C.B. 644). Accordingly, returns, claims for refund, statements and other documents given to a designated international delivery service before midnight on the last date prescribed for filing with the

Service will be deemed timely filed on the date the document was given to the delivery service, as recorded electronically on its data base or marked on the cover in which the item is to be delivered, as described in section 7502(f)(2)(C). If the last date for filing falls on a Saturday, Sunday, or a legal holiday within the meaning of section 7503, returns, claims, statements and other documents will be considered timely if given to a designated international delivery service before midnight on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. Timely filing treatment will also apply to documents filed with the United States Tax Court, such as petitions or notices of appeal, pursuant to section 7502(d)(1).

### HOLDINGS:

1. The Internal Revenue Service will accept, as timely filed, a federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service that is mailed from and officially postmarked in a foreign country on or before the last date prescribed for filing, including any extension of time for filing. If the last date for filing falls on a Saturday, Sunday, or a legal holiday within the meaning of section 7503, returns, claims, statements, and other documents will be considered timely if postmarked on or before the next succeeding day which is not a Saturday, Sunday, or a legal holiday.

2. A federal tax return, claim for refund, statement, or other document required or permitted to be filed with the Service or with the United States Tax Court that is given to a designated international delivery service before midnight on the last date prescribed for filing shall be deemed timely filed pursuant to section 7502(a), (d)(1), and (f)(1). If the last date for filing falls on a Saturday, Sunday, or a legal holiday within the meaning of section 7503, returns, claims, statements, and other documents will be considered timely if given to a designated international delivery service before midnight on the next succeeding day which is not a Saturday, Sunday, or a legal holiday. Such returns, claims for refund, statements, or other documents will be deemed filed on the date the document was given to the designated delivery service, as recorded electronically on its data base or marked on the cover in which the item is to be delivered pursuant to section 7502(f)(2)(C).

EFFECT ON OTHER REVENUE  
RULINGS:

Rev. Rul. 80-218 (1980-2 C.B. 386) is superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is David A. Abernathy of the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact Mr. Abernathy at (202) 622-7860 (not a toll-free call).

## Part III. Administrative, Procedural, and Miscellaneous

### Reporting Required Minimum Distributions From IRAs

#### Notice 2002-27

##### PURPOSE

This notice provides guidance on the reports that trustees, custodians, and issuers are required to make with respect to required minimum distributions from individual retirement accounts and annuities (IRAs).

##### BACKGROUND

Section 401(a)(9)(A) of the Internal Revenue Code provides rules for required minimum distributions from qualified plans during the life of an employee and § 401(a)(9)(B) provides rules for required minimum distributions after the death of an employee. Section 408(a)(6) and (b)(3) provides that rules similar to the rules of § 401(a)(9) apply to IRA distributions. Under § 401(a)(9)(C), the required beginning date for an IRA owner is April 1 of the calendar year following the calendar year in which the owner attains age 70½.

Section 408(i) provides that the trustee of an IRA shall make reports regarding such accounts as the Secretary may require.

Proposed regulations under §§ 401(a)(9) and 408(a)(6) and (b)(3) were published in January 2001 (REG-130477-00; REG-130481-00, 2001-1 C.B. 865). The proposed regulations, which substantially simplified the rules for determining required minimum distributions, provided that the trustee, custodian, or issuer of an IRA is required to report the amount of required minimum distributions from an IRA in accordance with IRS forms and instructions. For purposes of this notice, the term "trustee" includes a trustee, custodian, and an issuer of IRAs. The preamble to the proposed regulations described a process under which the IRS would be receiving public comments and consulting with interested parties in order to evaluate how to implement a reporting requirement that would provide the most useful information to the IRA owners and beneficiaries while minimizing the burden on IRA trustees.

The IRS has received a number of comments regarding the reporting requirement in the proposed regulations and the comments have been taken into account. Final and temporary regulations under §§ 401(a)(9) and 408(a)(6) and (b)(3) were published at 67 F.R. 18988 (Apr. 17, 2002). These regulations are effective January 1, 2003.

Section 1.408-8, Q&A-10, of the new regulations provides that the trustee of an IRA is required to report information, with respect to the amount required to be distributed from the IRA for each calendar year, to individuals or entities, at the time, and in the manner, prescribed by the Commissioner in revenue rulings, notices, and other guidance published in the Internal Revenue Bulletin as well as in federal tax forms and accompanying instructions. This notice is being issued in conjunction with those regulations and pursuant to this delegation of authority to require reporting with respect to required minimum distributions from IRAs.

The reporting provisions in this notice are intended to assist taxpayers in complying with the minimum distribution requirement. However, the Treasury and the IRS continue to have concerns about the overall level of compliance in this area and intend to monitor the effect of the new reporting regime on compliance to determine whether it would be appropriate to modify the regime in the future.

Although reporting of a required minimum distribution applies with respect to each IRA, the IRA owner may take the required minimum distribution from another IRA of the owner to the extent permitted under Q&A-9 of § 1.408-8.

##### REPORTING

###### I. Required Reporting to the IRA Owner

If a minimum distribution is required with respect to an IRA for a calendar year and the IRA owner is alive at the beginning of the year, the trustee that held the IRA as of December 31 of the prior year must provide a statement to the IRA owner by January 31 of the calendar year regarding the required minimum distribution in accordance with either of the two

alternatives in this section. This requirement is effective beginning with required minimum distributions for 2003 (so that the first reports are due January 31, 2003).

*Alternative one.* An IRA trustee furnishes the IRA owner with a statement of the amount of the required minimum distribution with respect to the IRA for the calendar year and the date by which such amount must be distributed. The amount is permitted to be calculated assuming that the sole beneficiary of the IRA is not a spouse more than 10 years younger than the IRA owner and that no amounts received by the IRA after December 31 of the prior year are required to be taken into account to adjust the value of the IRA as of December 31 of the prior year for purposes of determining the required minimum distribution pursuant to Q&A-7 or Q&A-8 of § 1.408-8.

*Alternative two.* An IRA trustee provides a statement to the IRA owner that: (1) informs the IRA owner that a minimum distribution with respect to the IRA is required for the calendar year and the date by which such amount must be distributed and (2) includes an offer to furnish the IRA owner, upon request, with a calculation of the amount of the required minimum distribution with respect to the IRA for that calendar year. If the IRA owner requests such a calculation, the IRA trustee must calculate the required minimum distribution for the IRA owner and report that amount to the IRA owner.

Under both alternatives, the statement must also inform the IRA owner that the trustee will be reporting to the IRS, beginning with required minimum distributions for calendar year 2004, that the IRA owner is required to receive a required minimum distribution for the calendar year. (See section II below.) The statement can be provided to the IRA owner in conjunction with the statement of the fair market value of the IRA as of December 31 of the prior year that is otherwise required to be provided to the IRA owner by January 31 of a year.

If the surviving spouse of a deceased IRA owner elects to treat an IRA for which the spouse is the sole beneficiary as the spouse's own IRA by redesignating the IRA as an account in the name of the

spouse as IRA owner rather than as beneficiary, the IRA trustee reports information on the required minimum distribution to the surviving spouse under the IRA owner rules in this section I. If the spouse is the sole beneficiary of an IRA of a deceased owner but has not affirmatively redesignated the IRA as the spouse's own IRA, the IRA trustee is permitted to assume that the surviving spouse of the deceased IRA owner has not elected to treat the IRA as the spouse's own IRA and continues to be treated as a beneficiary for purposes of § 401(a)(9).

## II. Required Reporting to the IRS

Beginning with required minimum distributions for calendar year 2004, if a minimum distribution is required with respect to an IRA for a calendar year, the trustee of the IRA must indicate that a minimum distribution is required with respect to the IRA for the calendar year (but need not indicate the amount) on Form 5498, *Individual Retirement Arrangement Information*, for the immediately preceding year (*i.e.*, on a 2003 Form 5498 for a 2004 required minimum distribution) in accordance with the instructions for Form 5498.

## III. No Reporting for Section 403(b) Contracts and IRAs of Deceased Owners

Section 1.403(b)-3 provides that a section 403(b) contract is treated as an individual retirement plan for purposes of satisfying the required minimum distribution rules. Consequently, the delegation of authority to require reporting for IRAs also applies to section 403(b) contracts. However, no reporting is required at this time with respect to required minimum distributions from section 403(b) contracts.

Reporting is also not required at this time with respect to IRAs of deceased owners. Accordingly, no reporting is required for Roth IRAs because there are no lifetime minimum distributions required for Roth IRAs. If reporting is required in the future for section 403(b) contracts or IRAs of deceased owners, the IRS will issue additional guidance, which will be effective prospectively.

## IV. Application for Years After 2003

This notice provides the reporting rules for required minimum distributions for calendar year 2003. For required minimum distributions for calendar years after 2003, these rules apply except to the extent modified in federal tax forms and accompanying instructions.

## PAPERWORK REDUCTION ACT

The collections of information contained in this notice have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. section 3507) under control number 1545-1779.

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

The collection of information in this notice is in the section titled "REPORTING." This information is required to inform IRA owners of their required minimum distributions for the year. The likely respondents are (1) businesses or other for-profit institutions and (2) not-for-profit institutions.

The estimated total annual reporting burden is 1,170,000 hours.

The estimated annual burden per respondent varies from 4 minutes to 20 hours, depending on individual circumstances, with an estimated average of 15 hours. The estimated number of respondents is 78,000.

The estimated annual frequency of responses is one.

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.

## DRAFTING INFORMATION

The principal authors of this notice are Steven Linder of the Employee Plans, Tax Exempt and Government Entities Division and Cathy Vohs of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this notice, contact the Employee Plans taxpayer assistance telephone service

between the hours of 8:00 a.m. and 6:30 p.m. Eastern Time, Monday through Friday by calling 1-877-829-5500 (a toll-free number). Mr. Linder can be reached at (202) 283-9888 (not a toll-free number). Ms. Vohs can be reached at (202) 622-6090 (not a toll-free number).

*26 CFR 601.204: Changes in accounting periods and methods of accounting.*

*(Also Part 1 §§, 162, 263A, 446, 447, 448, 460, 471, 481, 1001; 1.162-3, 1.263A-1, 1.446-1, 1.448-1T, 1.460-1, 1.471-1, 1.481-1, 1.481-4, 1.1001-1.)*

## Rev. Proc. 2002-28

### SECTION 1. PURPOSE

In order to reduce the administrative and tax compliance burdens on certain small business taxpayers and to minimize disputes between the Internal Revenue Service and small business taxpayers regarding the requirement to use an accrual method of accounting (accrual method) under § 446 of the Internal Revenue Code because of the requirement to account for inventories under § 471, this revenue procedure provides that the Commissioner of Internal Revenue will exercise his discretion to except a qualifying small business taxpayer (as defined in section 5.01 of this revenue procedure) from the requirements to use an accrual method of accounting under § 446 and to account for inventories under § 471. This revenue procedure also provides the procedures by which a qualifying small business taxpayer may obtain automatic consent to change to the cash receipts and disbursements method of accounting (cash method) and/or to a method of accounting for inventoriable items as materials and supplies that are not incidental under § 1.162-3 of the Income Tax Regulations.

### SECTION 2. BACKGROUND

.01 Section 446(a) provides that taxable income must be determined under the method of accounting on the basis of which the taxpayer regularly computes its income in keeping its books.

.02 Section 446(c) generally allows a taxpayer to select the method of accounting it will use to compute its taxable income. A taxpayer is entitled to adopt

any one of the permissible methods for each separate trade or business, including the cash method or an accrual method, subject to certain restrictions. For example, § 446(b) provides that the selected method must clearly reflect income. In addition, § 1.446-1(c)(2)(i) requires that a taxpayer use an accrual method with regard to purchases and sales of merchandise whenever § 471 requires the taxpayer to account for inventories, unless otherwise authorized by the Commissioner under § 1.446-1(c)(2)(ii). Under § 1.446-1(c)(2)(ii), the Commissioner has the authority to permit a taxpayer to use a method of accounting that clearly reflects income even though the method is not specifically authorized by the regulations.

.03 Section 447 generally requires the taxable income from farming of a C corporation engaged in the trade or business of farming, or a partnership engaged in the trade or business of farming with a C corporation partner, to be determined using an accrual method, unless the C corporation meets the \$1,000,000 (\$25,000,000 for family corporations) gross receipts test.

.04 Section 448 generally prohibits the use of the cash method by a C corporation (other than a farming business and a qualified personal service corporation) and a partnership with a C corporation partner (other than a farming business and a qualified personal service corporation), unless the C corporation or partnership with a C corporation partner meets a \$5,000,000 gross receipts test. Section 448 also prohibits tax shelters from using the cash method.

.05 The cash method generally requires an item of income to be included in income when actually or constructively received and permits a deduction for an expense when paid. Section 1.446-1(c)(1)(i). Other provisions of the Code or regulations applicable to cash method taxpayers may change these general rules, including, for example, § 263 (requiring the capitalization of expenses paid out for a new building or for permanent improvements or betterments made to increase the value of any property or estate, or for restoring property or making good the exhaustion of property for which an allowance is or has been made); § 263A (requiring capitalization of direct and

allocable indirect costs of real or tangible personal property produced by a taxpayer or real or personal property that is acquired by a taxpayer for resale); § 460 (requiring the use of the percentage-of-completion method for certain long-term contracts); and § 475 (requiring dealers in securities to mark securities to market).

.06 Section 471 provides that whenever, in the opinion of the Secretary, the use of inventories is necessary to clearly determine the income of the taxpayer, inventories must be taken by the taxpayer. Section 1.471-1 generally requires a taxpayer to account for inventories when the production, purchase, or sale of merchandise is an income-producing factor in the taxpayer's business.

.07 Section 1.162-3 requires taxpayers carrying materials and supplies (other than incidental materials and supplies) on hand to deduct the cost of materials and supplies only in the amount that they are actually consumed and used in operations during the taxable year. In the case of incidental materials and supplies on hand for which no record of consumption is kept or of which physical inventories at the beginning and end of the year are not taken, taxpayers may include in their expenses and deduct from gross income the total cost of such incidental supplies and materials as were purchased during the taxable year for which the return is made, provided the taxable income is clearly reflected by this method.

.08 Section 263A generally requires direct costs and an allocable portion of indirect costs of certain property produced or acquired for resale by a taxpayer to be included in inventory costs, in the case of property that is inventory, or to be capitalized, in the case of other property. However, resellers with gross receipts of \$10,000,000 or less are not required to capitalize costs under § 263A, and certain producers with \$200,000 or less of indirect costs are not required to capitalize certain costs under § 263A. See §§ 263A (b)(2)(B) and 1.263A-2(b)(3)(iv).

.09 Sections 446(e) and 1.446-1(e) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth

the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).

.10 Section 481(a) requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when the taxpayer's taxable income is determined under a method of accounting different from the method used to determine taxable income for the preceding taxable year.

### SECTION 3. SCOPE

.01 *Applicability.* This revenue procedure applies to a qualifying small business taxpayer as defined in section 5.01.

.02 *Taxpayers Not within the Scope of this Revenue Procedure.*

Notwithstanding section 3.01 of this revenue procedure, this revenue procedure does not apply to a farming business (within the meaning of § 263A(e)(4)) of a qualifying small business taxpayer. If a qualifying small business taxpayer is engaged in the trade or business of farming, this revenue procedure may apply to the taxpayer's non-farming trades or businesses, if any. A taxpayer engaged in the trade or business of farming generally is allowed to use the cash method for any farming business, unless the taxpayer is required to use an accrual method under § 447 or is prohibited from using the cash method under § 448.

### SECTION 4. QUALIFYING SMALL BUSINESS TAXPAYER EXCEPTION

.01 Pursuant to his discretion under §§ 446 and 471, and to simplify the recordkeeping requirements of a qualifying small business taxpayer, the Commissioner, as a matter of administrative convenience, will allow a qualifying small business taxpayer to use the cash method as described in this revenue procedure for a trade or business described in this section 4.01 (eligible trade or business).

(1) A qualifying small business taxpayer may use the cash method as described in this revenue procedure for all of its trades or businesses if the taxpayer satisfies any one of the following three tests and did not previously change (and was not previously required to have changed) from the cash method to an accrual method for any trade or business

as a result of becoming ineligible to use the cash method under this revenue procedure.

(a) The taxpayer reasonably determines that its principal business activity (as defined in section 5.04, below) is described in a North American Industry Classification System (“NAICS”) code other than one of the ineligible codes listed below. The ineligible NAICS codes are as follows:

- (i) mining activities within the meaning of NAICS codes 211 and 212;
- (ii) manufacturing within the meaning of NAICS codes 31–33;
- (iii) wholesale trade within the meaning of NAICS code 42;
- (iv) retail trade within the meaning of NAICS codes 44 and 45; and,
- (v) information industries within the meaning of NAICS codes 5111 and 5122.

Information regarding the NAICS codes can be found at [www.census.gov](http://www.census.gov). Visitors to the site should select “Subjects A to Z,” followed by “N,” and then should select “North American Industry Classification System.” Taxpayers also may find a partial list of NAICS codes, described as “Principal Business Activity Codes,” in the instructions to their tax return forms.

(b) Notwithstanding that a taxpayer’s principal business activity is described in one of the ineligible NAICS codes listed above in section 4.01(1)(a), the taxpayer reasonably determines that its principal business activity is the provision of services, including the provision of property incident to those services.

(c) Notwithstanding that a taxpayer’s principal business activity is described in one of the ineligible NAICS codes listed above in section 4.01(1)(a), the taxpayer reasonably determines that its principal business activity is the fabrication or modification of tangible personal property upon demand in accordance with customer design or specifications. For purposes of this rule, tangible personal property is not fabricated or modified in accordance with customer design or specifications if the customer merely chooses among pre-selected options (such as size, color, or materials) offered by the taxpayer or if the taxpayer must make only minor modifications to its basic design to meet the customer’s

specifications. Moreover, a taxpayer that manufactures an item in quantities for a customer is not treated as fabricating or modifying tangible personal property in accordance with customer design or specifications.

(2) Under current law, a taxpayer with two or more trades or businesses that has a trade or business that is permitted to use the cash method may use such method for such trade or business. Therefore, notwithstanding that a taxpayer’s principal business activity is not described above in section 4.01(1) and thus the taxpayer can not use the cash method for all of its trades or businesses, a taxpayer may use the cash method with respect to any separate and distinct trade or business if the principal business activity of the trade or business is not described in an ineligible NAICS code in section 4.01(1)(a)(i) through (v) or is described in either section 4.01(1)(b) or section 4.01(1)(c). No trade or business will be considered separate and distinct unless a complete and separable set of books and records is kept for such trade or business. See § 1.446–1(d)(2).

.02 A taxpayer who satisfies the qualifying small business taxpayer exception described in section 4.01 and chooses not to use an overall accrual method with inventories being accounted for under § 471 has the following three options for an eligible trade or business under this revenue procedure:

(1) The taxpayer can use the overall cash method and account for inventories under § 471;

(2) The taxpayer can use an overall accrual method and account for inventoriable items, as defined in section 5.09 below, in the same manner as materials and supplies that are not incidental under § 1.162–3 (see sections 4.04 and 4.05 below); or

(3) The taxpayer can use the overall cash method and account for inventoriable items in the same manner as materials and supplies that are not incidental under § 1.162–3 (see sections 4.04 and 4.05 below).

.03 Notwithstanding § 1001 and the regulations thereunder, qualifying small business taxpayers that use the cash method for an eligible trade or business under section 4.01 of this revenue procedure shall include amounts attributable to

“open accounts receivable” (as defined in section 5.10) in income as such amounts are actually or constructively received. However, § 1001 may be applicable to other transactions.

.04 Qualifying small business taxpayers that are permitted to use the cash method for an eligible trade or business under section 4.01 of this revenue procedure and that do not want to account for inventories under § 471 must treat all inventoriable items in such trade or business in the same manner as materials and supplies that are not incidental under § 1.162–3. For purposes of this revenue procedure, taxpayers are not required to apply § 263A to inventoriable items that are treated as materials and supplies that are not incidental. Items that would be accounted for as incidental materials and supplies for purposes of § 1.162–3 may still be accounted for in that manner. Whether an item is purchased for resale or use (and thus accounted for as a non-incidental material and supply) or is purchased to provide to customers incident to services (and thus may be accounted for as either an incidental or a non-incidental material and supply depending on the facts and circumstances) must be determined under general tax principles.

.05 Under § 1.162–3, materials and supplies that are not incidental are deductible only in the year in which they are actually consumed and used in the taxpayer’s business. For purposes of this revenue procedure, inventoriable items that are treated as materials and supplies that are not incidental are consumed and used in the year the qualifying small business taxpayer provides the items to a customer. Thus, the cost of such inventoriable items are deductible only in that year, or in the year in which the taxpayer actually pays for the goods, whichever is later. A qualifying small business taxpayer may determine the amount of the allowable deduction for non-incidental materials and supplies by using either a specific identification method, a first in, first out (FIFO) method, or an average cost method, provided that method is used consistently. See § 1.471–2(d). A taxpayer may not use the last in, first out (LIFO) method described in § 472 and the regulations thereunder to determine the amount of the allowable deduction for non-incidental materials and supplies.

.06 The method of accounting used by a qualifying small business taxpayer for financial accounting (“book”) purposes will not affect the taxpayer’s eligibility under this revenue procedure to use the cash method or the method of accounting for inventoriable items as non-incidentals materials and supplies under § 1.162–3. However, taxpayers must still comply with the requirements under § 446(a) and the regulations thereunder to maintain adequate books and records, which may include a reconciliation of any differences between such books and records and their return. See § 1.446–1(a)(4).

## SECTION 5. DEFINITIONS

.01 *Qualifying Small Business Taxpayer.* A qualifying small business taxpayer is any taxpayer with “average annual gross receipts” of \$10,000,000 or less that is not prohibited from using the cash method under § 448.

.02 *Average Annual Gross Receipts.* A taxpayer has average annual gross receipts of \$10,000,000 or less if, for each prior taxable year ending on or after December 31, 2000, the taxpayer’s average annual gross receipts for the three taxable-year period ending with the applicable prior taxable year do not exceed \$10,000,000. If a taxpayer has not been in existence for three prior taxable years, the taxpayer must determine its average annual gross receipts for the number of years (including short taxable years) that the taxpayer has been in existence. See § 448(c)(3)(A).

.03 *Business Activity.* A taxpayer may use any reasonable method of applying the relevant facts and circumstances to determine what is a business activity. For example, for some taxpayers, the provision of services, the sale of goods, and the production of goods each will be treated as a different business activity. However, if a taxpayer sells or produces goods incident to the performance of services, the different activities may be treated as one business activity—the provision of services.

.04 *Principal Business Activity.* A principal business activity is determined by the sources of gross receipts. Under sections 4.01(1)(a), (b), and (c), a taxpayer must apply the tests in this section to all the taxpayer’s trades or businesses in the aggregate. Under section 4.01(2), a tax-

payer must apply the tests in such section separately to each trade or business for which the taxpayer keeps a complete and separable set of books and records. A taxpayer may use either of the following tests to determine the principal business activity of the taxpayer or of the taxpayer’s trades or businesses.

(1) *Principal business activity prior year test.* Under the principal business activity prior year test, the principal business activity is the activity from which the largest percentage of gross receipts was derived during the prior taxable year (even if this amount is less than 50 percent of the aggregate gross receipts of the taxpayer or the trade or business). If a taxpayer or a trade or business is in its first taxable year, the principal business activity is the activity from which the largest percentage of gross receipts is derived for that taxable year.

(2) *Principal business activity three-year average test.* Under the principal business activity three-year average test, the principal business activity is the activity from which the largest percentage of average annual gross receipts was derived over the three taxable-year period ending with the prior taxable year. If a taxpayer or a trade or business has not been in existence for three prior taxable years, the taxpayer must determine average annual gross receipts for the number of years (including short taxable years) that the taxpayer or the trade or business has been in existence. See § 448(c)(3)(A).

.05 *Gross Receipts.* Gross receipts is defined consistent with § 1.448–1T(f)(2)(iv) of the Temporary Income Tax Regulations. Thus, gross receipts for a taxable year equal all receipts that must be recognized under the method of accounting actually used by the taxpayer for that taxable year for federal income tax purposes. For example, gross receipts include total sales (net of returns and allowances), all amounts received from services, interest, dividends, and rents. However, gross receipts do not include amounts received by the taxpayer with respect to sales tax or other similar state and local taxes if, under the applicable state or local law, the tax is legally imposed on the purchaser of the good or service, and the taxpayer merely collects and remits the tax to the taxing authority. See also § 448(c)(3)(C).

.06 *Aggregation of Gross Receipts.* For purposes of computing gross receipts under section 5.02, all taxpayers treated as a single employer under subsection (a) or (b) of § 52 or subsection (m) or (o) of § 414 (or that would be treated as a single employer under these sections if the taxpayers had employees) will be treated as a single taxpayer. However, when transactions occur between taxpayers that are treated as a single taxpayer by the previous sentence, gross receipts arising from these transactions will not be treated as gross receipts for purposes of the average annual gross receipts limitation. See §§ 448(c)(2) and 1.448–1T(f)(2)(ii).

.07 *Treatment of Short Taxable Years.* In the case of a short taxable year, a taxpayer’s gross receipts must be annualized by multiplying the gross receipts for the short taxable year by 12 and then dividing the result by the number of months in the short taxable year. See §§ 448(c)(3)(B) and 1.448–1T(f)(2)(iii).

.08 *Treatment of Predecessors.* Any reference to a taxpayer in this section 5 includes a reference to any predecessor of that taxpayer. See § 448(c)(3)(D).

.09 *Inventoriable Item Defined.* An inventoriable item is any item either purchased for resale to customers or used as a raw material in producing finished goods.

.10 *Open Accounts Receivable Defined.* For purposes of this revenue procedure, open accounts receivable is defined as any receivable due in full in 120 days or less.

## SECTION 6. EXAMPLES

For purposes of the following examples, assume that:

(1) the taxpayers use the calendar year;

(2) the taxpayers are not prohibited from using the cash method under § 448 (except *Example 4*); and

(3) the taxpayers satisfy the average annual gross receipts test of section 5.02 of this revenue procedure (except *Examples 2 and 3*).

*Example 1—Principal Business Activity Not an Ineligible NAICS Code.* Taxpayer is a graphic design firm. Taxpayer plans, designs, and manages the production of visual communications that convey specific messages or concepts. Taxpayer’s activities include the design of

printed materials, packaging, advertising, signage systems, and corporate identification (logos). Taxpayer reasonably determines that its principal business activity is described in NAICS code 541430 (graphic design services), which is not one of the ineligible NAICS codes listed in section 4.01(1)(a)(i)–(v) of this revenue procedure. Taxpayer may use the cash method for its graphic design business.

*Example 2—Satisfaction of the Average Annual Gross Receipts Test.* Taxpayer is a plumbing contractor that installs plumbing fixtures in customers' homes and businesses. Taxpayer reasonably determines that its principal business activity is construction, which is described in NAICS code 23. Taxpayer's gross receipts at the end of the three preceding taxable years are:

	<i>Gross receipts</i>
1998:	\$ 6,000,000
1999:	9,000,000
2000:	12,000,000

Taxpayer's average annual gross receipts for the three taxable-year period ending in the 2000 taxable year are \$9,000,000 (((\$6,000,000 + \$9,000,000 + \$12,000,000) / 3 = \$9,000,000). Taxpayer may use the cash method for all its trades or businesses pursuant to this revenue procedure for its 2001 taxable year because its average annual gross receipts for each prior taxable year ending on or after December 31, 2000, is \$10,000,000 or less and its principal business activity is not described in the ineligible NAICS codes listed in section 4.01(1)(a)(i)–(v).

*Example 3—Failure of the Average Annual Gross Receipts Test.* Same as *Example 2*, except that Taxpayer's gross receipts in 2001 equal \$15,000,000. Taxpayer's average annual gross receipts for the three taxable-year period ending in the 2001 taxable year are \$12,000,000 (((\$9,000,000 + \$12,000,000 + \$15,000,000) / 3) = \$12,000,000). Taxpayer is not a qualifying small business taxpayer for purposes of this revenue procedure for its 2002 taxable year or any subsequent year because its average annual gross receipts for each prior taxable year ending on or after December 31, 2000, is not \$10,000,000 or less.

*Example 4—Inability to Use this Revenue Procedure When § 448 Applies.* Same as *Example 2*, except that Taxpayer is a C corporation. Because Taxpayer's average annual gross receipts for the previous three years (\$9,000,000) exceed \$5,000,000, Taxpayer is prohibited from using the cash method under § 448. Consequently, Taxpayer is not eligible to use the cash method under this revenue procedure. The same result would apply under § 448 if, instead of being a C corporation, Taxpayer were a tax shelter (regardless of Taxpayer's average annual gross receipts) or Taxpayer were a partnership with a C corporation as a partner.

*Example 5—Principal Business Activity Prior Year Test.* Taxpayer is a plumbing contractor that installs plumbing fixtures in customers' homes and businesses. Taxpayer also has a store that sells plumbing equipment to homeowners and other plumbers who visit the store. During its prior taxable year, Taxpayer derived 60 percent of its total receipts from plumbing installation (including

amounts charged for parts and fixtures used in installation) and 40 percent of its total receipts from the sale of plumbing equipment through its store. Under the principal business activity prior year test, Taxpayer reasonably determines that its principal business activity is plumbing installation, which is a construction activity described in NAICS code 23. Because Taxpayer's principal business activity—plumbing installation—is not described in the ineligible NAICS codes listed in section 4.01(1)(a)(i)–(v), Taxpayer may use the cash method for both business activities (plumbing installation and retail sales).

*Example 6—Principal Business Activity Three-Year Average Test.* Same as *Example 5*, except that for the prior taxable year, Taxpayer derived 40 percent of its total receipts from plumbing installation (including amounts charged for parts and fixtures used in installation) and 60 percent of its total receipts from the sale of plumbing equipment through its store. Under the principal business activity prior year test, Taxpayer's principal business activity is retail, which is described in an ineligible NAICS code. Thus, Taxpayer is not eligible to use the cash method for all of its trades or businesses under the principal business activity prior year test. However, Taxpayer may still be eligible to use the cash method for all of its trades or businesses under section 4.01(1) of this revenue procedure if Taxpayer reasonably determines that its principal business activity is plumbing installation under the principal business activity three-year average test. Taxpayer's gross receipts for the prior three taxable years are as follows:

	2000	1999	1998	3 Year Average
Plumbing installation	\$2,000,000	\$6,000,000	\$4,000,000	\$4,000,000
Retail sale of equipment	<u>\$3,000,000</u>	<u>\$2,000,000</u>	<u>\$4,000,000</u>	<u>\$3,000,000</u>
Total	\$5,000,000	\$8,000,000	\$8,000,000	\$7,000,000

The approximate percentage of Taxpayer's average annual gross receipts for the prior three taxable years is 57 percent (\$4,000,000/\$7,000,000 total average gross receipts) for plumbing installation and 43 percent (\$3,000,000/\$7,000,000) for the retail sale of plumbing equipment

through its store. Thus, Taxpayer reasonably determines that its principal business activity is plumbing installation under the principal business activity three-year average test. Because Taxpayer's principal business activity—plumbing installation—is not described in the ineli-

gible NAICS codes listed in section 4.01(1)(a)(i)–(v), Taxpayer may use the cash method for both business activities (plumbing and retail sales).

*Example 7—Application of Section 4.01(2) Where Taxpayer Is Ineligible to Use the Cash Method Under Section*

4.01(1). Same as *Examples 5 and 6*, except that Taxpayer's principal business activity is retail sales under both the principal business activity prior year test and the principal business activity three-year average test. Taxpayer is not eligible to use the cash method for all of its trades or businesses under section 4.01(1) because Taxpayer's principal business activity (retail sales) is described in an ineligible NAICS code under section 4.01(1)(a)(iv) and is neither the provision of services under section 4.01(1)(b) nor the fabrication or modification of tangible personal property under section 4.01(1)(c). Taxpayer, however, maintains its retail sales and plumbing installation activities as separate and distinct businesses with a complete and separable set of books and records for each business. Under section 4.01(2) of the revenue procedure, Taxpayer may use the cash method for its separate plumbing installation business notwithstanding that its principal business activity (retail sales) is ineligible under section 4.01(1)(a)–(c).

*Example 8—A Principal Business Activity Can Account for Less Than 50 Percent of Gross Receipts.* Taxpayer has four activities, Activities A through D. During the prior taxable year, Taxpayer derived 35 percent of its gross receipts from Activity A, 25 percent from Activity B, 20 percent from Activity C, and 20 percent from Activity D. Under the principal business activity prior year test, Activity A would be Taxpayer's principal business activity because it represents the largest percentage of gross receipts. Similarly, if the percentages of Taxpayer's average annual gross receipts for the prior three taxable years were 35 percent from Activity A, 25 percent from Activity B, 20 percent from Activity C, and 20 percent from Activity D, under the principal business activity three-year average test, Activity A would be Taxpayer's principal business activity because it represents the largest percentage of average annual gross receipts.

*Example 9—Taxpayer Does Not Satisfy the NAICS Code Exception in Section 4.01(1)(a), the Service Exception in Section 4.01(1)(b), or the Custom Manufacturing Exception in Section 4.01(1)(c).* Taxpayer sells refrigerators. As part of the sale price, Taxpayer delivers the refrigerator to the customer and confirms that

the refrigerator is functioning properly at the customer's site. Taxpayer's principal business activity is described in the ineligible NAICS code 44. Moreover, Taxpayer's principal business activity is not the provision of services under section 4.01(1)(b). Taxpayer does not provide refrigerators incident to the performance of services. Rather, Taxpayer performs certain services (delivery and confirmation of functionality) incident to the sale of refrigerators. In addition, Taxpayer does not fabricate or modify tangible personal property under section 4.01(1)(c). Taxpayer may not use the cash method under this revenue procedure.

*Example 10—Taxpayer Does Not Satisfy the NAICS Code Exception in Section 4.01(1)(a), the Service Exception in Section 4.01(1)(b), or the Custom Manufacturing Exception in Section 4.01(1)(c).* Taxpayer is a sofa manufacturer that only produces sofas upon receipt of a customer order. Customers are allowed to pick among 150 different fabrics offered by the Taxpayer or to provide their own fabric, which the Taxpayer will use to finish the customer's sofa. Taxpayer's principal business activity is described in the ineligible NAICS code 33. Taxpayer does not provide sofas incident to the performance of services for purposes of section 4.01(1)(b). Rather, Taxpayer performs certain services (upholstering) incident to the sale of sofas. Taxpayer also does not fabricate or modify tangible personal property for purposes of section 4.01(1)(c) because customers merely choose among pre-selected options offered by Taxpayer and Taxpayer only makes minor modifications to the basic design of its sofa. Taxpayer may not use the cash method under this revenue procedure.

*Example 11—Taxpayer Does Not Satisfy the NAICS Code Exception in Section 4.01(1)(a), the Service Exception in Section 4.01(1)(b) or the Custom Manufacturing Exception in Section 4.01(1)(c).* Taxpayer is a publisher who produces and sells high school and college yearbooks. Taxpayer's principal business activity is described in the ineligible NAICS code 5111 (newspaper, periodical, book, and database publishers). Taxpayer is not providing a service for purposes of section 4.01(1)(b) because Taxpayer's principal business activity is the production of

yearbooks for customers. In addition, Taxpayer is not a custom manufacturer for purposes of section 4.01(1)(c) because Taxpayer, although it produces yearbooks to the detailed specifications of schools, is producing yearbooks in quantities. As such, Taxpayer may not use the cash method under this revenue procedure.

*Example 12—Taxpayer Creating Prototype Does Not Satisfy the NAICS Code Exception in Section 4.01(1)(a) but Does Satisfy the Custom Manufacturing Exception in Section 4.01(1)(c).* Taxpayer makes tools based entirely on specific designs and specifications provided to it by customers. Taxpayer produces the customer's prototype and gives the prototype to the customer for production. Taxpayer's principal business activity is described in the ineligible NAICS code 33. However, Taxpayer's principal business activity is the fabrication of tangible personal property upon demand in accordance with customer design or specifications for purposes of section 4.01(1)(c). Taxpayer may use the cash method under this revenue procedure (subject to the potential application of § 460).

*Example 13—Taxpayer Producing Quantities of Prototype Does Not Satisfy the Custom Manufacturing Exception in Section 4.01(1)(c).* Same as *Example 12*, except that instead of producing the customer's prototype and giving the prototype to the customer for further production, Taxpayer is also the producer of the customer's goods using the prototype. Taxpayer's principal business activity would not fall under the custom manufacturer exception of section 4.01(1)(c).

*Example 14—Application of Accounts Receivable 120-Day Rule in Section 4.03.* Taxpayer is eligible to use the cash method under this revenue procedure. Taxpayer chooses to use the cash method and to account for inventoriable items as non-incidentals materials and supplies under § 1.162–3. In December 2001, Taxpayer transfers property to a customer in exchange for an open accounts receivable (due in full in 120 days or less). In February 2002, the customer satisfies the accounts receivable when it pays cash to Taxpayer. As provided by section 4.03 of this revenue procedure, Taxpayer would not include any amount attributable to the accounts receivable in income in 2001. Rather, Taxpayer would include the full

amount of the accounts receivable in income in 2002 when it actually receives the cash payment from the customer.

*Example 15—Timing of Deduction for Inventoriable Items Treated as Non-Incidental Materials and Supplies Under § 1.162-3—Construction.* Taxpayer is a roofing contractor that is eligible to use the cash method under this revenue procedure. Taxpayer chooses to use the cash method and to account for inventoriable items as non-incidental materials and supplies under § 1.162-3. Taxpayer enters into a contract with a homeowner in December 2001 to replace the homeowner's roof. Taxpayer purchases roofing shingles from a local supplier and has them delivered to the homeowner's residence. Taxpayer pays the supplier \$5,000 for the shingles upon their delivery later that month. Taxpayer replaces the homeowner's roof in December 2001, and gives the homeowner a bill for \$15,000 at that time. Taxpayer receives a check from the homeowner in January 2002. The shingles are non-incidental materials and supplies. The cost of the shingles is deductible in the year Taxpayer uses and consumes the shingles or actually pays for the shingles, whichever is later. In this case, Taxpayer both pays for the shingles and uses the shingles (by providing the shingles to the customer in connection with the performance of roofing services) in 2001. Thus, Taxpayer deducts the \$5,000 cost of the shingles on its 2001 federal income tax return. Taxpayer includes the \$15,000 in income in 2002 when it receives the check from the homeowner.

*Example 16—Timing of Deduction for Inventoriable Items Treated as Non-Incidental Materials and Supplies Under § 1.162-3—Construction.* Same as in *Example 15*, except that Taxpayer does not replace the roof until January 2002 and is not paid until March 2002. Because the shingles are not used until 2002, their cost can only be deducted on Taxpayer's 2002 federal income tax return notwithstanding that Taxpayer paid for the shingles in 2001. Thus, on its 2002 return, Taxpayer must report \$15,000 of income and \$5,000 of deductions.

*Example 17—Timing of Deduction for Non-Inventoriable Items—Speculative Home Sales.* Taxpayer is eligible to use

the cash method as described in this revenue procedure. Taxpayer is a speculative builder of houses that are built on land it owns. In 2001, Taxpayer builds a house using various items such as lumber, piping, and metal fixtures that it had paid for in 2000. In 2002, Taxpayer sells the house to a buyer. Because the house is real property held for sale by Taxpayer, the house and the material used to build the house are not inventoriable items under this revenue procedure. Thus, Taxpayer may not account for the items used to build the house as non-incidental materials and supplies under § 1.162-3. Rather, Taxpayer must capitalize the costs of the lumber, piping, metal fixtures and other goods used by Taxpayer to build the house under § 263. Upon the sale of the house in 2002, the costs capitalized by Taxpayer will be offset against the house sales price to determine Taxpayer's gain or loss from the sale.

*Example 18—Timing of Deduction for Inventoriable Items Treated as Non-Incidental Materials and Supplies Under § 1.162-3—Construction.* Same as in *Example 17*, except that (1) Taxpayer builds houses on land its customers own, and (2) the houses are built in three months with payment due at completion. Because Taxpayer does not own the house, the lumber, piping, metal fixtures and other goods used by Taxpayer in the provision of construction services are inventoriable items, not real property held for sale. Taxpayer elects to treat the goods used to build the house as non-incidental materials and supplies under § 1.162-3. Taxpayer must deduct the cost of the lumber, piping, metal fixtures and other non-incidental materials and supplies that are used by it to build the house in 2001 (the year those items were used by Taxpayer to build the house) notwithstanding that Taxpayer had paid for the items in 2000. Taxpayer will report income it receives from its customer as the income is actually or constructively received.

*Example 19—Timing of Deduction for Inventoriable Items Treated as Non-Incidental Materials and Supplies Under § 1.162-3—Reseller.* Taxpayer is a veterinarian that also sells pet supplies from its clinic. Taxpayer reasonably determines that its principal business activity is veterinary services, which is not described in one of the ineligible NAICS codes in sec-

tion 4.01(1)(a)(i)-(v). Consequently, Taxpayer is eligible to use the cash method for all its business activities (veterinary services and retail sales). For both business activities, Taxpayer chooses to use the cash method and to account for inventoriable items (such as pet food) as non-incidental materials and supplies under § 1.162-3. In December of 2001, Taxpayer purchases and pays for pet food to be resold from its clinic. Taxpayer sells the pet food from its clinic (and receives cash payment from the customer) in 2002. Because the pet food is not provided to customers until 2002, its cost can not be deducted until 2002.

*Example 20—Timing of Deduction for Inventoriable Items Treated as Non-Incidental Materials and Supplies Under § 1.162-3—Manufacturer.* Taxpayer is a landscape designer that also manufactures lawn ornaments. Taxpayer does not manufacture lawn ornaments pursuant to customer contracts. Taxpayer reasonably determines that its principal business activity is landscape design, which is not described in an ineligible NAICS code under section 4.01(1)(a)(i)-(v). Consequently, Taxpayer is eligible to use the cash method for all its business activities (landscape design and lawn ornament manufacturing). For both business activities, Taxpayer chooses to use the cash method and to account for inventoriable items (such as raw materials) as non-incidental materials and supplies under § 1.162-3. In 2001, Taxpayer purchases and pays for raw materials to be used in its manufacturing business and uses the raw materials to produce lawn ornaments. During 2002, Taxpayer sells the lawn ornaments to customers. Because the lawn ornaments are not provided to customers until 2002, the cost of the raw materials used to produce the lawn ornaments can not be deducted until 2002.

*Example 21—Application of Long Term Contract Rules—§ 460 Applicable.* Taxpayer is a specialty tool and die manufacturer. Taxpayer receives a request from a large automobile manufacturer to design and produce a custom-made die that the customer will use in its manufacturing operation. The contract to manufacture the die is entered into in December 2001 but is not completed until May 2002. Because it satisfies the requirements of section 4.01(1)(c) of this

revenue procedure, Taxpayer is eligible to use the overall cash method of accounting. Notwithstanding the Taxpayer's eligibility to use the overall cash method, however, because the contract to manufacture the custom-made die requires the production of a "unique item" and will not be completed in the year it is entered into, it is a "long term contract" for purposes of § 460, and the income and expense relating to that contract must be accounted for under the percentage-of-completion method of accounting described in § 460 and the underlying regulations.

*Example 22—Application of Long Term Contract Rules—§ 460 Not Applicable.* Taxpayer is a residential home builder that specializes in modest single family homes whose construction period averages six months. Taxpayer uses an overall accrual method of accounting, and although it is not required to do so, Taxpayer has elected to use the percentage-of-completion method of accounting, as described in § 1.460-4(b), in accounting for its home construction activities. Because its principal business activity is not described in an ineligible NAICS code described in section 4.01(1)(a), Taxpayer may elect the overall cash method described in this revenue procedure. Further, because its home construction activity is not required to be accounted for using the percentage-of-completion method described in § 460, Taxpayer is eligible (but not required) to change its method of accounting for that activity to the cash method.

*Example 23—Taxpayer Satisfies the NAICS Code Provision in Section 4.01(1)(a).* Taxpayer is a licensed medical clinic that provides specialized chemotherapy treatment to cancer patients. The medication provided to patients accounts for 26 percent of Taxpayer's average annual gross receipts. Taxpayer does not sell the medications separately from its provision of services, selects the medications to be used in a particular session based on its own professional skill and judgment, and does not maintain medications for more than two weeks. Because the provision of medical services (NAICS code 62) represents Taxpayer's principal business activity, Taxpayer qualifies to use the cash method under section 4.01(1)(a) for all of its trades or busi-

nesses. Even if the cost of the chemotherapy medications represented Taxpayer's principal source of gross receipts, Taxpayer nonetheless would qualify to use the cash method under section 4.01(1)(a) of this revenue procedure, because its principal business activity would still be providing medical services, with goods being provided only incident to the provision of those services. See *Osteopathic Medical Oncology and Hematology, P.C. v. Commissioner*, 113 T.C. 376 (1999), *acq. in result* 2000-1 C.B. xvi.

*Example 24—Change in Principal Business Activity.* Taxpayer owns a hardware store and a small appliance repair business. Following the issuance of this revenue procedure, Taxpayer reasonably determined that its principal business activity was its appliance repair business, which is not described in an ineligible NAICS code under section 4.01(1)(a)(i)-(v). Consequently, Taxpayer was eligible to use the cash method under this revenue procedure for both its business activities (appliance repair and retail sales). Over time, Taxpayer's hardware store began to generate a larger portion of Taxpayer's gross receipts than its repair business. In 2005, Taxpayer's retail business became its principal business activity. Because retail trade is described in ineligible NAICS code 44, starting in 2006, Taxpayer is no longer eligible to use the cash method for all its trades or businesses under section 4.01(1). Accordingly, Taxpayer must change to an accrual method for its retail business. If Taxpayer maintains a complete and separable set of books and records in 2006 for its repair business, Taxpayer may continue to use the cash method for its repair business under section 4.01(2). If Taxpayer does not maintain a complete and separable set of books and records in 2006 for its repair business, Taxpayer also must change to an accrual method for its repair business—however, in any subsequent taxable year that Taxpayer maintains complete and separable books and records for its repair business, Taxpayer will be eligible under section 4.01(2) to change to the cash method for its repair business.

*Example 25—Change in Principal Business Activity.* Same as *Example 24*, except that Taxpayer's repair business again becomes its principal business

activity in 2009. Taxpayer is no longer eligible to use the cash method for its retail business under section 4.01(1). For section 4.01(1) to apply, Taxpayer must not have previously changed (or have been previously required to change) from the cash method to an accrual method for any trade or business as a result of becoming ineligible to use the cash method under this revenue procedure. Because Taxpayer was required to change to an accrual method for its retail business in 2006 as a result of becoming ineligible to use the cash method under this revenue procedure, Taxpayer is not eligible to rely on section 4.01(1) for 2006 or any subsequent taxable year.

*Example 26—Change in Principal Business Activity.* Same as *Example 24*, except that following the issuance of this revenue procedure, Taxpayer's principal business activity was retail sales and Taxpayer used an accrual method for both businesses (retail and repair). Over time, Taxpayer's repair business began to generate a larger portion of Taxpayer's gross receipts than its retail business. In 2007, Taxpayer's repair business became its principal business activity. Starting in taxable year 2008, Taxpayer is eligible under section 4.01(1) to use the cash method for all its trades and businesses because Taxpayer did not change (and was not required to have changed) from the cash method to an accrual method for any trade or business as a result of becoming ineligible to use the cash method for that trade or business under this revenue procedure, and Taxpayer's principal business activity is no longer described in an ineligible NAICS code under section 4.01(1)(a)(i)-(v).

## SECTION 7. CHANGE IN ACCOUNTING METHOD

.01 *In General.* Any change in a taxpayer's method of accounting pursuant to this revenue procedure is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply.

.02 *Automatic Change for Taxpayers within the Scope of this Revenue Procedure.*

(1) *Automatic change to the cash method.* A qualifying small business taxpayer that wants to use the cash method as described in this revenue procedure for

an eligible trade or business must follow the automatic change in accounting method provisions of Rev. Proc. 2002-9 (2002-3 I.R.B. 327) (or its successor), as modified by Rev. Proc. 2002-19 (2002-13 I.R.B. 696), and Announcement 2002-17 (2002-8 I.R.B. 561), with the following modifications:

(a) The scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply. However, if the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, see section 6.02(9) of Rev. Proc. 2002-9 for additional filing requirements.

(b) Taxpayers filing Form 3115, *Application for Change in Accounting Method*, for a change in method of accounting under this revenue procedure must complete all applicable parts of the form but need not complete Part II of Schedule A of Form 3115. Specifically, Part II of Form 3115, line 17 (regarding information on gross receipts in previous years) and Part III of Form 3115 (regarding the § 481(a) adjustment) must be completed. Taxpayers should write "Filed under Rev. Proc. 2002-28" at the top of their Form 3115.

(c) A taxpayer making a change under section 7.02 of this revenue procedure for its first taxable year ending on or after December 31, 2001, that, on or before May 6, 2002, files or filed its original federal income tax return for such year, is not required to comply with the filing requirement in section 6.02(3)(a) of Rev. Proc. 2002-9, provided the taxpayer complies with the following filing requirement. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for the taxpayer's first taxable year ending on or after December 31, 2001. This amended return must be filed no later than September 16, 2002. A copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 2002-9 for the address) no later than when the taxpayer's amended return is filed.

(2) *Automatic change to § 1.162-3.* A qualifying small business taxpayer that does not want to account for inventories under § 471 must make any necessary change from the taxpayer's inventory

method (and, if applicable, from the method of capitalizing costs under § 263A) to treat inventoriable items in the same manner as materials and supplies that are not incidental under § 1.162-3. For purposes of such a change, the rules of section 7.02(1) of this revenue procedure apply.

(3) *Other automatic changes.* An automatic change in method under this revenue procedure would also include any other change in method of accounting that is eligible to be made under this revenue procedure in conjunction with either or both of the above changes in this section 7.02 (such as a change from a long-term contract method that is not required to be used by § 460). For purposes of such a change, the rules of section 7.02(1) of this revenue procedure apply.

(4) *Single Form 3115.* Any combination of changes under this revenue procedure may be included in the same Form 3115 to be filed by the taxpayer.

#### .03 Section 481(a) Adjustment.

(1) *Determining the net amount.* The net amount of the § 481(a) adjustment computed under this revenue procedure must take into account both increases and decreases in the applicable account balances such as accounts receivable, accounts payable, and inventory. For example, the § 481(a) adjustment may include the difference resulting from changing from taking inventory accounts under § 471 to treating the inventoriable items as materials and supplies that are not incidental under § 1.162-3.

(2) *Multiple adjustments.* In the event that a taxpayer is taking into account a § 481(a) adjustment from another accounting method change in addition to the § 481(a) adjustment required by this revenue procedure, the § 481(a) adjustments would be taken into account separately. For example, a taxpayer that changed from the cash method to an accrual method in 1999 and was required to take its § 481(a) adjustment into account over four years would continue to take into account that adjustment over the appropriate four years even though the taxpayer changes back to the cash method in 2001 and has an additional § 481(a) adjustment required by this revenue procedure.

(3) *Section 481(a) adjustment period.* As provided in section 2 of Rev. Proc.

2002-19, the period for negative § 481(a) adjustments is one year, and the period for positive § 481(a) adjustments is four years.

#### .04 Taxpayers Not within the Scope of this Revenue Procedure.

(1) A taxpayer that ceases to qualify for the qualifying small business taxpayer exception described in section 4 of this revenue procedure for a trade or business and that otherwise is required to use an accrual method for that trade or business must change to an accrual method (and, if applicable an inventory method that complies with §§ 263A and 471) for that trade or business using either the automatic change in accounting method provisions of section 5.01 of the APPENDIX to Rev. Proc. 2002-9, if applicable, as modified by Rev. Proc. 2002-19 or the advance consent provisions of Rev. Proc. 97-27 (1997-1 C.B. 679) (or its successor), as modified by Rev. Proc. 2002-19.

(2) No inference is intended regarding whether a taxpayer that does not satisfy the qualifying small business taxpayer exception in section 4 is otherwise permitted to use the cash method. Taxpayers who do not qualify to change to the cash method under this revenue procedure may still request permission to change to the cash method under Rev. Proc. 97-27, as modified. See also Rev. Proc. 2001-10 (2001-1 C.B. 272).

## SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2002-9 is modified and amplified to include this automatic change in sections 5 and 9 of the APPENDIX. Notice 2002-14 (2002-8 I.R.B. 548) is modified and superseded.

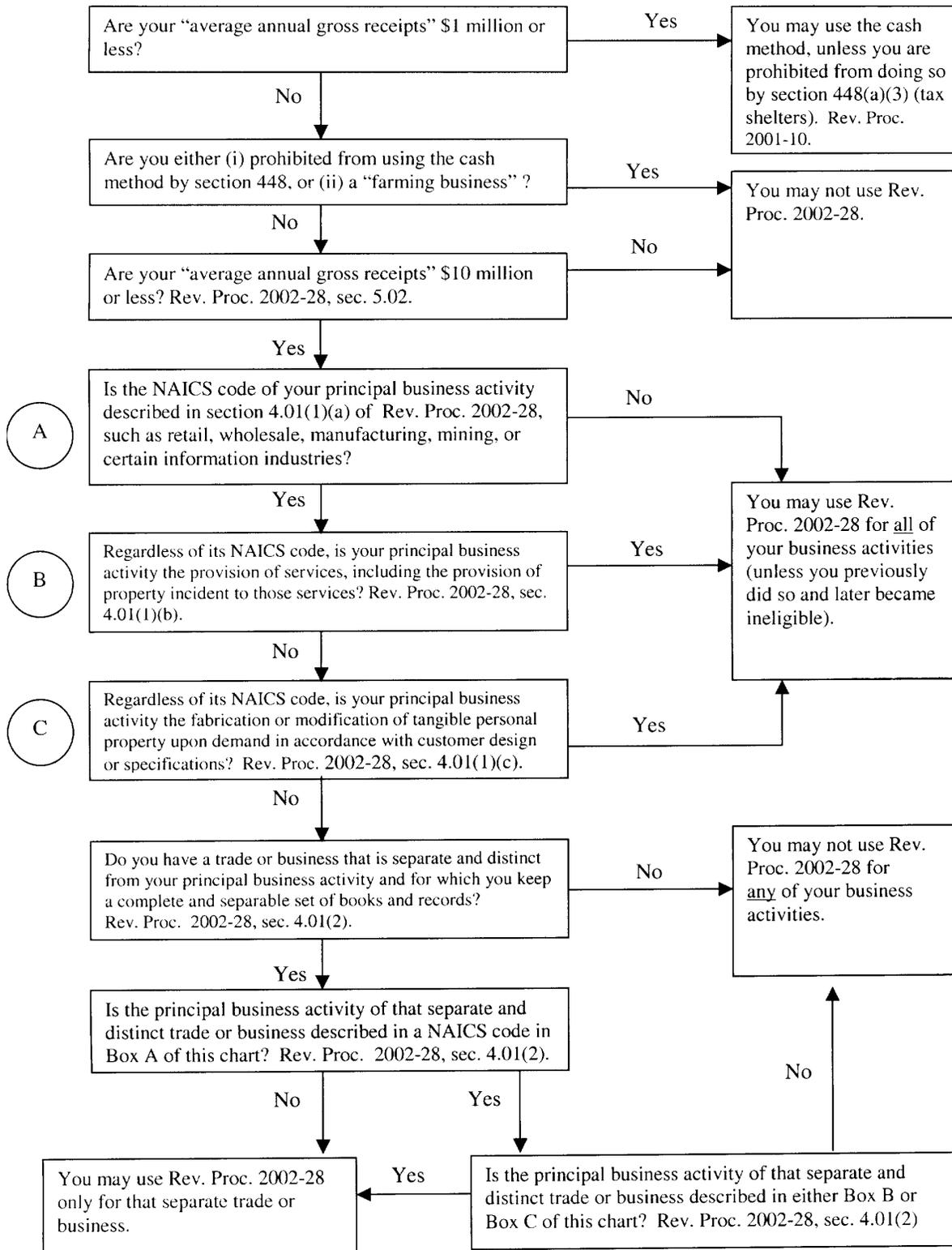
## SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending on or after December 31, 2001. However, the Service will not challenge a taxpayer's use of the cash method under § 446 or a taxpayer's failure to account for inventories under § 471 for a trade or business in an earlier year if the taxpayer, for that year, would have been a qualifying small business taxpayer as described in section 5.01 of this revenue procedure and would have been eligible to use the cash method in such year under section 4 of this revenue procedure if this revenue procedure had been applicable to that taxable year.

The principal author of this revenue procedure is W. Thomas McElroy, Jr., of

the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. McElroy at (202) 622-4970 (not a toll-free call).

APPENDIX  
APPLICATION OF REV. PROC. 2002-28



## Part IV. Items of General Interest

### Notice of Proposed Rulemaking

#### Levy Restrictions During Installment Agreements

##### REG-104762-00

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to restrictions on levy during the period that an installment agreement is proposed or in effect. The proposed regulations reflect changes to the law made by the Internal Revenue Service Restructuring and Reform Act of 1998.

DATE: Written or electronically generated comments and requests for a public hearing must be received by July 16, 2002.

ADDRESSES: Send submissions to: CC:ITA:RU (REG-104762-00), room 5226, 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 5 p.m. to: CC:ITA:RU (REG-104762-00), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Frederick W. Schindler, (202) 622-3620; concerning submissions of comments or requests for a hearing Treena Garret, (202) 622-7180 (not toll-free numbers).

##### SUPPLEMENTARY INFORMATION:

##### Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301)

under section 6331 of the Internal Revenue Code (Code). The proposed regulations reflect the amendment of section 6331 by section 3462 of the Internal Revenue Service Restructuring and Reform Act of 1998 Public Law, 105-206, (112 Stat. 685, 764) (RRA 1998). New subsection 6331(k) codifies the IRS practice of withholding collection during consideration of a taxpayer's offer to compromise and extends that practice to proposed installment agreements. The proposed regulations deal principally with the effect of subsection 6331(k) when an installment agreement has been proposed and is pending, is in effect, or has been rejected or terminated.

Prior to the enactment of RRA 1998, the IRS had a long-standing practice of staying action to collect a liability while an offer to compromise that liability was being evaluated and considered, unless the interests of the United States would be jeopardized by doing so. See Policy Statement P-5-97 (Approved July 10, 1959), reprinted at IRM 1.5.17. To insure that the interests of the United States would not be jeopardized while collection was withheld, the IRS required that taxpayers execute a waiver of the statute of limitations for collection of the liabilities the taxpayer was attempting to compromise.

Section 3462 of RRA 1998 added subsection 6331(k) to the Code. Paragraph (1) of the new subsection codifies the IRS policy of withholding collection during the pendency of an offer to compromise by prohibiting levy while an offer to compromise is pending, for thirty days after a rejection, and during any appeal of that rejection. Temporary regulations (T.D. 8829, 1999-2 C.B. 235) published in the **Federal Register** on July 21, 1999, contained provisions governing the effects of subsection 6331(k) when taxpayers submit offers to compromise. See § 301.7122-1T.

Prior to RRA 1998, the IRS did not stay collection when a taxpayer submitted an offer of an installment agreement. Because installment agreements provide for the full payment of the tax liabilities at issue, the processing of requests for installment agreements is less formal and most requests were accepted or rejected

within several days of receipt. Once an installment agreement took effect, regulations prohibited levy, as well as certain other enforced collection measures, unless the installment agreement provided otherwise. See § 301.6159-1(d).

Paragraph 6331(k)(2) prohibits levy while a taxpayer's proposal of an installment agreement is pending with the IRS, for thirty days after rejection of such a proposal, while an installment agreement is in effect, for thirty days after termination of an installment agreement by the IRS, and during a timely filed appeal by the taxpayer to the IRS Office of Appeals of a rejection or termination decision.

Paragraph 6331(k)(3) provides that "rules similar to" those contained in paragraphs (3), (4), and (5) of subsection 6331(i) shall apply generally for the purposes of subsection 6331(k). Subsection 6331(i) governs the prohibition on levy during the pendency of a proceeding for refund of a divisible tax. The cross-referenced provisions provide exceptions to the prohibitions on levy, prohibit the initiation by the IRS of court proceedings to collect while the refund proceeding is pending, and provide that the statute of limitations for collection is suspended while levy is prohibited.

The proposed regulations implement the provisions of subsection 6331(k) as they relate to installment agreements. In addition to setting forth the periods during which levy is prohibited, they adapt the rules of paragraphs (3), (4), and (5) of subsection 6331(i) in a manner tailored to the installment agreement process. The legislative history accompanying RRA 1998 explains that Congress did not intend that levy would be prohibited if the IRS determined that an offer to compromise was submitted solely to delay collection. H.R. Conf. Rep. No. 509, 105th Cong., 2d Sess. 288 (1998). Because the legislative history indicates that Congress intended the same restrictions on levy with respect to offers in compromise be applicable to installment agreements, these proposed regulations adopt the same rule with respect to proposed installment agreements that are submitted solely to delay collection.

## Explanation of Provisions

The proposed regulations provide that, subject to certain exceptions, the IRS may not levy to collect a liability while a proposal to enter into an installment agreement for payment of that liability is pending, for thirty days after rejection of such a proposal, while an installment agreement is in effect, for thirty days after termination of an installment agreement by the IRS, and during a timely filed appeal of a rejection or termination by the IRS. A proposed installment agreement is considered pending when it is accepted for processing by the IRS, and remains pending until the IRS accepts or rejects it or the taxpayer withdraws the proposal. If a proposed installment agreement does not contain sufficient information for the IRS to determine whether the proposal should be accepted, the IRS will request the additional necessary information from the taxpayer and provide a reasonable time period for the taxpayer to respond. The IRS may reject the proposed installment agreement if the requested information is not provided.

Collection by levy is not prohibited if the taxpayer waives the restriction on levy in writing, if the IRS determines that the proposed installment agreement was submitted solely to delay collection, or if the IRS determines that collection of the tax liability is in jeopardy.

The proposed regulations provide that the IRS may take actions other than levy to protect the interests of the United States with respect to collection of the liability to which an installment agreement or proposed installment agreement relates. Those actions include, but are not limited to: crediting an overpayment against the liability pursuant to section 6402, filing or refiling notices of Federal tax lien, and taking action to collect from persons liable for the tax but not named in the installment agreement.

Under the proposed regulations, the IRS cannot institute a court proceeding against the taxpayer named in the installment agreement to collect the tax covered by the installment agreement. The IRS, however, may file a claim in any bankruptcy proceeding, insolvency action, or interpleader case commenced by other creditors of the taxpayer. The IRS also may join the taxpayer in any suit insti-

tuted by or against another person liable for payment of the same liability—*i.e.*, in situations where the liability for the tax may be established or disputed. Such proceedings may involve taxes for which more than one person may be jointly and severally liable for the same tax, or may involve persons liable for related liabilities, such as a trust fund recovery penalty under section 6672 or a personal liability for excise tax under section 4103.

While an installment agreement allows the IRS to accept the payment of tax in installments, the agreement does not conclusively establish the taxpayer's liability. A taxpayer therefore is not prohibited from seeking a refund of taxes paid pursuant to an installment agreement. Allowing the IRS to join the taxpayer in a proceeding where the liability for the tax may be established or disputed will protect the Government from having to litigate the same tax in multiple forums only to face the argument in each separate case (including, potentially, from the taxpayer named in an installment agreement) that the person or persons not party to that suit were solely or principally liable for non-payment of the taxes at issue. The proposed regulations provide, however, that if a taxpayer named in an installment agreement is joined in a proceeding and the IRS obtains a judgment against that person, then collection will continue to occur pursuant to the terms of the installment agreement.

The regulations provide that the statute of limitations for collection under section 6502 is suspended while a proposed installment agreement is pending, for thirty days after rejection or termination of an installment agreement, and during a timely filed appeal of the rejection or termination decision. The running of the collection statute resumes, however, after an installment agreement takes effect. The statute of limitations for collection shall continue to run if an exception under this section applies and levy is not prohibited with respect to the taxpayer.

These regulations apply to installment agreements proposed or entered into on or after the date final regulations are published in the **Federal Register**. However, the rules set forth in these regulations mirror practices the IRS has been following administratively since the enactment of RRA 1998.

## Special Analyses

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

## Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronically generated comments that are submitted timely to the IRS. The IRS generally requests any comments on the clarity of the proposed rule and how it may be made easier to understand.

All comments will be available for public inspection and copying.

A public hearing may be scheduled if requested in writing by a person that timely submits written comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the **Federal Register**.

## Drafting Information

The principal author of these regulations is Frederick W. Schindler, Office of the Associate Chief Counsel (Procedure & Administration), Collection, Bankruptcy & Summonses Division.

\* \* \* \* \*

## Proposed Amendments to the Regulations

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

PART 301 — PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Sections 301.6331-3 and 301.6331-4 are added to read as follows:

§ 301.6331-3 *Restrictions on levy while offers to compromise are pending.*

*Cross-reference.* For provisions relating to the making of levies while an offer to compromise is pending, see § 301.7122-1T.

§ 301.6331-4 *Restrictions on levy while installment agreements are pending or in effect.*

(a) *Prohibition on levy*—(1) *In general.* No levy may be made to collect a tax liability that is the subject of an installment agreement during the period that a proposed installment agreement is pending with the Internal Revenue Service (IRS), for 30 days immediately following the rejection of a proposed installment agreement, during the period that an installment agreement is in effect, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, no levy may be made while the rejection or termination is being considered by Appeals.

(2) *When a proposed installment agreement becomes pending.* A proposed installment agreement becomes pending when it is accepted for processing. The proposed installment agreement remains pending until the IRS accepts the proposal, the IRS notifies the taxpayer that the proposal has been rejected, or the proposal is withdrawn by the taxpayer. If a proposed installment agreement that has been accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the proposal should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable

time period after such a request, the IRS may reject the proposed installment agreement.

(3) *Revised proposals of installment agreements submitted following rejection.* If, following the rejection of a proposed installment agreement, the taxpayer makes a good faith revision of the proposal and submits the revision within 30 days of the date of rejection, no levy may be made while the IRS considers the revised proposal of an installment agreement.

(4) *Exceptions.* Paragraph (a)(1) of this section shall not prohibit levy if the taxpayer files a written notice with the IRS that waives the restriction on levy imposed by this section, the IRS determines that the proposed installment agreement was submitted solely to delay collection, or the IRS determines that collection of the tax to which the installment agreement or proposed installment agreement relates is in jeopardy. This section will not prohibit levy to collect from any person other than the person named on the installment agreement.

(b) *Other actions by the IRS while levy is prohibited*—(1) *In general.* The IRS may take actions other than levy to protect the interests of the Government with regard to the liability named in an installment agreement or proposed installment agreement. Those actions include, for example—

(i) Crediting an overpayment against the liability pursuant to section 6402;

(ii) Filing or refiling notices of Federal tax lien; and

(iii) Taking action to collect from any person who is not named on the installment agreement or proposed installment agreement but who is liable for the tax to which the installment agreement relates.

(2) *Proceedings in court.* The IRS will not begin a proceeding in court for the collection of any liability to which an installment agreement or proposed installment agreement relates against a person named in that installment agreement while levy is prohibited by paragraph (a)(1) of this section. In any refund action, however, the IRS may file a counterclaim or third-party complaint against a person without regard to whether that person is named in an installment agreement or proposed installment agreement.

In addition, the IRS may join a person named in an installment agreement in any other proceeding in which liability for the tax that is the subject of the installment agreement may be established or disputed, and may file a claim in any bankruptcy proceeding, insolvency action, or interpleader case commenced by other creditors of the taxpayer. If a person named in an installment agreement is joined in a proceeding and the IRS obtains a judgment against that person, collection will continue to occur pursuant to the terms of the installment agreement.

(c) *Statute of limitations*—(1) *Suspension of the statute of limitations on collection.* The statute of limitations under section 6502 for collection of any liability shall be suspended during the period that a proposed installment agreement is pending with the IRS, for 30 days immediately following the rejection of a proposed installment agreement, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with the IRS Office of Appeals, the statute of limitations for collection shall be suspended while the rejection or termination is being considered by Appeals. The statute of limitations for collection shall continue to run if an exception under paragraph (a)(4) of this section applies and levy is not prohibited with respect to the taxpayer.

(2) *Waivers of the statute of limitations on collection.* The IRS may continue to request, to the extent permissible under section 6502 and § 301.6159-1, that the taxpayer agree to a reasonable extension of the statute of limitations for collection.

(d) *Effective date.* This section is applicable on the date final regulations are published in the **Federal Register**.

Robert E. Wenzel,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on April 16, 2002, 8:45 a.m., and published in the issue of the Federal Register for April 17, 2002, 67 F.R. 18839)

## Withdrawal of Previous Notice of Proposed Rulemaking; Notice of Proposed Rulemaking and Notice of Public Hearing

### Arbitrage and Private Activity Restrictions Applicable to Tax-Exempt Bonds Issued by State and Local Governments; Investment-Type Property (Prepayment); Private Loan (Prepayment).

REG-105369-00

**SUMMARY:** This document contains proposed amendments to the final regulations on the arbitrage and private activity restrictions applicable to tax-exempt bonds issued by State and local governments. The proposed amendments affect issuers of tax-exempt bonds and provide guidance on the definitions of investment-type property and private loan to help issuers comply with the arbitrage and private activity restrictions. This document also provides notice of a public hearing on these proposed regulations. The previous notice of proposed rulemaking (REG-113526-98, 1999-2 C.B. 417), published on August 25, 1999, relating to arbitrage and related restrictions applicable to tax-exempt bonds issued by State and local governments, is withdrawn.

**DATES:** Written or electronic comments must be received by July 16, 2002. Outlines of topics to be discussed at the public hearing scheduled for September 24, 2002, at 10 a.m., must be received by September 10, 2002.

**ADDRESSES:** Send submissions to: CC:ITA:RU (REG-105369-00), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:ITA:RU (REG-105369-00), courier's desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, submissions may be made electronically to the IRS Internet site at [www.irs.gov/regs](http://www.irs.gov/regs). The public hearing will be held in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Johanna Som de Cerff, (202) 622-3980; concerning submissions and the hearing, Sonya Cruse, (202) 622-7180 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

#### Background

#### Background

This document contains proposed amendments to 26 CFR part 1 (the proposed regulations). On August 25, 1999, the IRS published in the **Federal Register** a notice of proposed rulemaking (REG-113526-98) (64 FR 46320) (the 1999 proposed regulations) proposing to modify § 1.148-1(e) of the Income Tax Regulations to establish which prepayments for property or services give rise to investment-type property under section 148(b)(2)(D) of the Internal Revenue Code (Code). Numerous written comments responding to the 1999 proposed regulations were received, and a public hearing was held on January 12, 2000. In response to the extensive comments, particularly with regard to certain natural gas prepayment transactions discussed below, the 1999 proposed regulations are withdrawn and amendments to § 1.148-1(e) are proposed in accordance with this notice of proposed rulemaking. This notice of proposed rulemaking also proposes corresponding amendments to § 1.141-5(c)(2) (relating to the private loan financing test).

#### Explanation of Provisions

##### I. Existing Definition of Investment-type Property

With certain exceptions, section 148 prohibits the use of proceeds of a tax-exempt bond issue to acquire investment property with a yield that materially exceeds the yield on the issue. Section 148(b)(2)(D) provides that the term *investment property* includes *investment-type property*. Section 148(b)(2)(D) was added to the Code by the Tax Reform Act of 1986, Pub. L. No. 99-514, 100 Stat. 2085 (1986) (1986 Act). The Conference Committee Report states that the legisla-

tion “expands the types of investments of bond proceeds that are subject to the arbitrage restrictions to include all investment-type property (including other than customary prepayments)....” H.R. Conf. Rep. No. 99-841, pt. 2, at 745.

As an economic matter, prepayments for property or services generally contain a built-in investment return. That is, if a buyer of property or services makes a cash payment to the seller in advance of the seller's performance, the buyer may expect to receive an implicit investment return based on the time value of money. In the case of a prepayment financed with tax-exempt bond proceeds, the presence of a built-in investment return raises the issue of whether the prepayment gives rise to investment-type property.

The existing regulations, at § 1.148-1(e)(2), contain rules for determining when a prepayment for property or services results in investment-type property. Under that provision, a prepayment generally gives rise to investment-type property if a principal purpose for prepaying is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. However, a prepayment does not give rise to investment-type property under the existing regulations if (1) it is made for a substantial business purpose other than investment return and the issuer has no commercially reasonable alternative to the prepayment (the business purpose exception); or (2) prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing (the customary exception).

##### II. 1999 Proposed Amendments to the Definition of Investment-type Property

The 1999 proposed regulations proposed a modification to § 1.148-1(e)(2) to establish that a prepayment of a contract for property or services that is made after the date that the contract is entered into can give rise to investment-type property. This modification was proposed in light of the opinion in *City of Columbus v. Commissioner*, 112 F.3d 1201 (D.C. Cir. 1997), which concluded that a 1994 prepayment by a city of its indebtedness to a state did not constitute a prepayment for property the city acquired in

1967. The proposed amendment to § 1.148-1(e)(2) addressed only the narrow issue of whether a prepayment for property or services after the execution of a contract to buy the property or services can give rise to investment-type property.

Commentators generally agreed with the suggestion that a prepayment for property or services can occur after the date the purchase contract is executed. The proposed regulations retain the proposed change to § 1.148-1(e)(2), with clarifying modifications that are consistent with this concept.

### III. Definition of Investment-type Property in the Proposed Regulations

Although commentators generally agreed with the 1999 proposed amendments to § 1.148-1(e)(2), they requested additional clarification of other aspects of the definition of *investment-type property*. After considering all of the comments, Treasury and the IRS have determined that additional changes to the definition are needed to provide certainty to issuers and the IRS in a manner that is consistent with the broad scope of the investment-type property concept. To allow for public comment, these additional changes are issued in proposed form. Furthermore, to provide issuers with immediate certainty, issuers may rely on the proposed regulations to the extent specified below.

Commentators generally did not recommend modifying the basic framework for determining whether a prepayment gives rise to investment-type property under § 1.148-1(e)(2). The proposed regulations retain this basic structure, but make certain modifications. In particular, the proposed regulations: (1) amend the business purpose exception; (2) retain the customary exception in its present form; (3) add an exception for certain prepayments by municipal utilities to acquire a supply of natural gas; and (4) add a *de minimis* exception for prepayments made within 90 days of delivery of the property or services. In addition, the proposed regulations state that the Commissioner may, by published guidance, set forth additional circumstances in which a prepayment does not give rise to investment-type property.

#### A. Business purpose exception

As indicated, the existing regulations provide that a prepayment does not give rise to investment-type property if it is made for a substantial business purpose other than investment return and the issuer has no commercially reasonable alternative to the prepayment. This provision, which was intended to be a narrow exception to the definition of investment-type property, has raised difficult interpretive questions. For example, in many instances it may be unclear whether the alternatives available to the issuer are “commercially reasonable.”

Commentators suggested certain changes to the provision to clarify its application. For example, they suggested that a prepayment should be considered made for a substantial business purpose other than investment return if the effect of the prepayment is (1) to fix the price of the property or service, (2) to assure a supply of the property or service, (3) to guarantee delivery of the property or service at a location favorable to the issuer, or (4) to enable the issuer to obtain a price discount that materially exceeds the investment return that could be earned between the time the prepayment is made and the time the property or services are delivered. Commentators suggested that an alternative should be viewed as “commercially reasonable” if it is reasonably available to the issuer, it would achieve the same substantial business purpose as the prepayment except that no investment return is received, and it is not more expensive by an amount that materially exceeds the investment return from the prepayment. Some commentators recommended that a safe harbor be added under which an alternative would not be considered commercially reasonable if the cost of the alternative exceeded the cost of the prepayment by a specified amount on a present value basis.

Treasury and the IRS have considered these suggested factors and have concluded that they do not, in and of themselves, represent administrable standards for distinguishing between prepayments that are made primarily for arbitrage purposes and those that are not. That is, a prepayment transaction may contain one or more of these features, even if it is primarily arbitrage-motivated. Therefore, the proposed regulations do not adopt these

suggested amendments. Nevertheless, as discussed below, these factors are taken into account, together with all the other facts and circumstances, in determining whether a prepayment satisfies the business purpose exception as revised by the proposed regulations.

In this regard, the proposed regulations amend the business purpose exception in order to clarify that it is to be applied narrowly in a manner that is consistent with the broad scope of the investment-type property concept. In particular, under the proposed regulations a prepayment meets the business purpose exception if the facts and circumstances clearly establish that the primary purpose for the prepayment is to accomplish one or more substantial business purposes that (1) are unrelated to any investment return based on the time value of money, and (2) cannot be accomplished without the prepayment. This exception is intended to be very narrow and to apply only in very unique circumstances, such as the situation illustrated by an example in the proposed regulations.

#### B. Customary exception

As indicated, the existing regulations provide that a prepayment does not give rise to investment-type property if prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing. This provision implements the legislative history cited above that indicates that customary prepayments should not result in investment-type property.

Commentators suggested that a safe harbor be added for determining a “substantial percentage” of similarly situated persons. However, Treasury and the IRS have concluded that the determination of whether a transaction is customary is appropriately made on a case-by-case basis, taking into account all the facts and circumstances, rather than by reference to a precise mathematical formula or predetermined percentage. Therefore, the proposed regulations do not adopt this suggested change.

Commentators also recommended that the “substantial percentage” requirement should be deemed satisfied if a substantial number of similarly situated persons who

are not beneficiaries of tax-exempt financing make a similarly sized prepayment. The proposed regulations do not adopt this comment because the incidence of a particular number of transactions by similarly situated persons may not establish that the transaction is customary if those persons represent only a small percentage of all the similarly situated persons.

Finally, some commentators suggested that the customary exception should be automatically satisfied if the issuer and the supplier of the property or services certify reasonably and in good faith that its requirements are met. The proposed regulations do not adopt this comment because a certification by the parties to a transaction should not be sufficient to establish the legal conclusion that the transaction meets the requirements of the exception.

#### C. *Certain prepayments to acquire a supply of natural gas*

The preamble to the 1999 proposed regulations identified certain transactions involving the issuance of bonds to prepay for a supply of natural gas and the simultaneous execution by the issuer of a commodity swap under which the issuer receives fixed payments and makes variable payments based on an index. The 1999 preamble stated that Treasury and the IRS were concerned that the transactions create investment-type property and requested comments on the transactions.

Most, but not all, of the commentators disagreed with the suggestion that the identified transactions should result in investment-type property. They stated that deregulation of the natural gas industry has threatened the ability of municipal utilities to obtain a secure supply of natural gas on commercially reasonable terms. They stated that the natural gas prepayment transactions are necessary to obtain a guaranteed supply of natural gas on favorable terms in light of deregulation.

The proposed regulations add an exception to the definition of investment-type property for certain natural gas prepayments that are made by or for one or more utilities that are owned by a governmental person, as defined in § 1.141-1(b) (for example, where a joint action agency acquires a natural gas supply for one or more municipal gas or electric

utilities). The exception applies only if at least 95 percent of the natural gas purchased with the prepayment is to be consumed by retail customers in the service area of a municipal gas utility, or used to produce electricity that will be furnished to retail customers that a municipal electric utility is obligated to serve under state or Federal law. For this purpose, the service area of a municipal gas utility is defined as (1) any area throughout which the municipal utility provided (at all times during the five-year period ending on the issue date) gas transmission or distribution service, and any area that is contiguous to such an area, or (2) any area where the municipal utility is obligated under state or Federal law to provide gas distribution services as provided in such law. Issuers may apply principles similar to the rules of § 1.141-12 in order to cure a violation of this 95 percent requirement.

A transaction will not fail to qualify for this exception by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. For this purpose, a swap contract is an independent contract if the obligation of each party to perform under the swap contract is not dependent on performance by any person (other than the other party to the swap contract) under another contract (for example, a gas supply contract or another swap contract).

Comments are requested on the exception for natural gas prepayments in the proposed regulations, including the definition of service area and the workability of the 95 percent test.

#### D. *De minimis prepayments*

Commentators recommended adding to the regulations a *de minimis* exception under which prepayments that are made in small amounts or shortly before the property or services are delivered, would be disregarded. Treasury and the IRS recognize that prepayments made shortly before the property or services are delivered are unlikely to be arbitrage-motivated. Based on this consideration, and to provide administrative certainty, the proposed regulations add an exception for prepayments that are made within 90

days of the date of delivery of the property or services. However, the proposed regulations do not provide an exception for small prepayments because a prepayment may be made primarily for arbitrage purposes even if it is a small amount.

#### E. *Timing mismatch between payment and delivery of property or services*

The preamble to the 1999 proposed regulations requested comments regarding the proper treatment of contracts that provide for a timing mismatch between the buyer's cash payments and the seller's delivery of property or services.

Commentators generally expressed the view that, depending on the particular facts, payments made over time may give rise to investment-type property when the payment schedule does not match the schedule for the provision of property or services. The commentators did not recommend any changes to the regulations on this issue. Treasury and the IRS have determined that § 1.148-1(e)(2) appropriately addresses mismatches in payment and delivery obligations. Therefore, the proposed regulations do not propose any amendments in this regard.

#### F. *Prepayments of capital charges*

Some commentators recommended that the regulations be modified to provide that a prepayment does not give rise to investment-type property if it is in substance a reimbursement to a seller of all or a portion of the seller's capital costs of a specific, tangible project through which the seller produces or delivers a service or commodity. The proposed regulations do not contain a specific exception for prepayments that reimburse a seller for its capital costs because a prepayment may be made primarily for arbitrage purposes even if it effectively reimburses the seller for capital costs. Nevertheless, this factor is taken into account, together with all the other facts and circumstances, in determining whether a prepayment meets the business purpose exception.

#### IV. *Private Loans*

With certain exceptions, interest on an issue that meets the private loan financing test is not excluded from gross income. Under section 141(c), an issue generally meets the private loan financing test if more than the lesser of 5 percent or \$5

million of its proceeds are used to make loans to nongovernmental persons. Section 1.141-5(c)(1) states that, for purposes of the private loan financing test, a loan may arise from the direct lending of bond proceeds or may arise from transactions in which indirect benefits that are the economic equivalent of a loan are conveyed. Thus, the determination of whether a loan is made depends on the substance of a transaction rather than its form. *See also* H.R. Conf. Rep. No. 99-841, pt. 2, at 692.

The existing regulations, at § 1.141-5(c)(2)(ii), provide that a prepayment for property or services generally is treated as a loan for purposes of the private loan financing test if a principal purpose for prepaying is to provide a benefit of tax-exempt financing to the seller. However, under the existing regulations a prepayment is not treated as a loan for purposes of the private loan financing test if (1) it is made for a substantial business purpose other than providing a benefit of tax-exempt financing to the seller and the issuer has no commercially reasonable alternative to the prepayment; or (2) prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing. The proposed regulations amend the private loan provisions of § 1.141-5(c)(2) to conform to the amendments to the definition of investment-type property in this notice of proposed rulemaking.

### Proposed Effective Date

The proposed regulations will apply to bonds sold on or after the date of publication of final regulations in the **Federal Register**. However, issuers may apply the proposed regulations in whole, but not in part, to any issue that is sold on or after the date the proposed regulations are published in the **Federal Register** and before the effective date of the final regulations.

### Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It has also been determined that section

553(b) of the Administrative Procedures Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

### Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments that are submitted timely (preferably a signed original and eight copies) to the IRS. The Treasury Department and IRS 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 September 24, 2002, at 10 a.m. in the Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts.

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 by July 16, 2002, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by September 10, 2002.

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

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

### Drafting Information

The principal authors of these regulations are Rebecca L. Harrigal and Johanna Som de Cerff, Office of Chief Counsel (TE/GE), IRS, and Stephen J. Watson, Office of Tax Policy, Treasury Department. 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. In § 1.141-5, paragraph (c) is amended as follows:

1. Paragraph (c)(2)(ii) introductory text is revised.

2. Paragraph (c)(2)(ii)(A) is revised.

3. Paragraph (c)(2)(ii)(B) is amended by removing the period at the end of the paragraph and adding a semicolon in its place.

4. Paragraphs (c)(2)(ii)(C), (c)(2)(ii)(D), and (c)(2)(iii) are added.

The revisions and additions read as follows:

#### § 1.141-5 Private loan financing test.

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) *Certain prepayments treated as loans.* Except as otherwise provided, a prepayment for property or services, including a prepayment for property or services that is made after the date that the contract to buy the property or services is entered into, is treated as a loan for purposes of the private loan financing test if a principal purpose for prepaying is to provide a benefit of tax-exempt financing to the seller. A prepayment is not treated as a loan for purposes of the private loan financing test if—

(A) The primary purpose for the prepayment is to accomplish one or more substantial business purposes that—

(1) Are unrelated to providing any benefit of tax-exempt financing to the seller; and

(2) Cannot be accomplished without the prepayment;

\* \* \* \* \*

(C) The prepayment is made within 90 days of the date of delivery to the issuer of all of the property or services for which the prepayment is made; or

(D) The prepayment meets the requirements of § 1.148-1(e)(2)(ii) (relating to certain prepayments to acquire a supply of natural gas).

(iii) *Additional prepayments as permitted by the Commissioner.* The Commissioner may, by published guidance, set forth additional circumstances in which a prepayment is not treated as a loan for purposes of the private loan financing test.

\* \* \* \* \*

Par. 3. In § 1.148-1, paragraphs (e)(1) and (2) are revised to read as follows:

§ 1.148-1 *Definitions and elections.*

\* \* \* \* \*

(e) *Investment-type property*—(1) *In general.* Investment-type property includes any property, other than property described in sections 148(b)(2)(A), (B), (C), or (E), that is held principally as a passive vehicle for the production of income. For this purpose, production of income includes any benefit based on the time value of money.

(2) *Prepayments*—(i) *In general.* Except as otherwise provided in this paragraph (e)(2), a prepayment for property or services, including a prepayment for property or services that is made after the date that the contract to buy the property or services is entered into, also gives rise to investment-type property if a principal purpose for prepaying is to receive an investment return from the time the prepayment is made until the time payment otherwise would be made. A prepayment does not give rise to investment-type property if—

(A) The primary purpose for the prepayment is to accomplish one or more substantial business purposes that—

(1) Are unrelated to any investment return based on the time value of money; and

(2) Cannot be accomplished without the prepayment;

(B) Prepayments on substantially the same terms are made by a substantial percentage of persons who are similarly situated to the issuer but who are not beneficiaries of tax-exempt financing;

(C) The prepayment is made within 90 days of the date of delivery to the issuer of all of the property or services for which the prepayment is made; or

(D) The prepayment meets the requirements of paragraph (e)(2)(ii) of this section.

(ii) *Certain prepayments to acquire a supply of natural gas*—(A) *In general.* A prepayment meets the requirements of this paragraph (e)(2)(ii) if—

(1) It is made by or for one or more utilities that are owned by a governmental person, as defined in § 1.141-1(b) (*municipal utility*), to purchase a supply of natural gas; and

(2) At least 95 percent of the natural gas purchased with the prepayment is to be consumed by retail gas customers in the service area (as defined in paragraph (e)(2)(ii)(B) of this section) of a municipal utility, or used to produce electricity that will be furnished to retail electric customers that a municipal utility is obligated to serve under state or Federal law. An obligation that arises solely by reason of a contract is not an obligation to serve under state or Federal law.

(B) *Service area.* For purposes of paragraph (e)(2)(ii)(A)(2) of this section, the service area of a municipal utility shall consist of—

(1) Any area throughout which the municipal utility provided (at all times during the 5-year period ending on the issue date) gas transmission or distribution service, and any area that is contiguous to such an area; or

(2) Any area where the municipal utility is obligated under state or Federal law to provide gas distribution services as provided in such law.

(C) *Commodity swaps.* A prepayment does not fail to meet the requirements of this paragraph (e)(2)(ii) by reason of any commodity swap contract that may be entered into between the issuer and an unrelated party (other than the gas supplier), or between the gas supplier and an unrelated party (other than the issuer), so long as each swap contract is an independent contract. A swap contract is an independent contract if the obligation of each party to perform under the swap contract is not dependent on performance by any person (other than the other party to the swap contract) under another contract (for example, a gas supply contract or another swap contract).

(iii) *Additional prepayments as permitted by the Commissioner.* The Commissioner may, by published guidance, set

forth additional circumstances in which a prepayment does not give rise to investment-type property.

(iv) *Examples.* The following examples illustrate the application of this paragraph (e)(2):

*Example 1. Prepayment after contract is executed.* In 1998, City A enters into a ten-year contract with Company Y. Under the contract, Company Y is to provide services to City A over the term of the contract and in return City A will pay Company Y for its services as they are provided. In 2004, City A issues bonds to finance a lump sum payment to Company Y in satisfaction of City A's obligation to pay for Company Y's services to be provided over the remaining term of the contract. The use of bond proceeds to make the lump sum payment constitutes a prepayment for services under paragraph (e)(2)(i) of this section, even though the payment is made after the date that the contract is executed.

*Example 2. Prepayment necessary to accomplish substantial business purpose.* Authority is a governmental unit that furnishes electricity to the general public. In 1995, Authority enters into a 15-year agreement (the Agreement) with Power Company to obtain certain of its power requirements. In 2003, Authority enters into another contract (the Purchase Contract) with Power Company to obtain a specified amount of additional firm power through 2013. The rates paid by Authority under the Purchase Contract are based on a fixed capacity charge, which reflects Power Company's average cost of certain plants and equipment, and a variable energy charge, which reflects Power Company's average system energy costs to operate the utility, primarily fuel costs. Simultaneously with entering into the Purchase Contract, Authority issues a \$30 million issue with a 6 percent yield and uses the proceeds to make a lump sum payment to Power Company to prepay for the entire fixed capacity charge under the Purchase Contract. Authority pays the variable energy charges as energy is actually delivered. Power Company reports the lump sum payment for Federal tax purposes as income from the sale of capacity. Power Company also agrees to certain concessions under the Agreement, including the elimination of floors on capacity charges and a moratorium on capacity charge increases for five years. The discount rate used to compute the amount of the prepayment is 18 percent, compounded semi-annually. Power Company's taxable borrowing rate for a loan of a comparable size to the prepayment, with a term that coincides with the term of the Purchase Contract, is 8 percent, compounded semiannually. The prepayment allows Power Company to offer a low capacity charge to Authority, yet prevent other wholesale customers from taking advantage of the proposal. Under Federal rate-making guidelines, if Power Company had offered Authority a contract based on fixed periodic capacity charges, Power Company would have been obligated to offer the same capacity charges to its other wholesale customers (which would have been expected to accept the offer). Power Company is willing to offer Authority the lower capacity charge and to make the other concessions because it owns surplus generating capacity. Thus, it is important to Power Company to maintain its customer base. The loss of a significant customer

such as Authority would require that Power Company either succeed in obtaining regulatory authorization to increase its rates charged to other customers or suffer a diminished return on capital. Power Company will not build additional generating facilities directly or indirectly by reason of its obligations under the Purchase Contract, and at the time it entered into the Purchase Contract, it had already incurred capital costs of facilities, which, if allocated to Authority's demands for energy under the Purchase Contract, would exceed the up-front capacity charge. Under paragraph (e)(2)(i)(A) of this section, the prepayment does not give rise to investment-type property.

\* \* \* \* \*

Robert E. Wenzel,  
*Deputy Commissioner of  
Internal Revenue.*

(Filed by the Office of the Federal Register on April 12, 2002, 4:12 p.m., and published in the issue of the Federal Register for April 17, 2002, 67 F.R. 18835)

## Changes in Method of Accounting

### Announcement 2002-45

#### PURPOSE

Beginning with the publication of Rev. Proc. 2001-10 (2001-1 C.B. 272) superseding Rev. Proc. 2000-22 (2000-1 C.B. 1008), the Internal Revenue Service (IRS) and Treasury Department have been working to reduce the administrative and tax compliance burdens on small business taxpayers and to minimize disputes between the IRS and these taxpayers regarding the requirement to use an accrual method of accounting under § 446 of the Internal Revenue Code because of the requirement to account for inventories under § 471. Rev. Proc. 2001-10 permits any small business taxpayer having average annual gross receipts of \$1 million or less (other than tax shelters) to use the cash receipts and disbursements method of accounting (the cash method), regardless of the nature of its trade or business. Rev. Proc. 2001-10 also permits these businesses to treat as non-incidentals materials and supplies under § 1.162-3 of the Income Tax Regulations items that otherwise would be accounted for as inventory.

In December 2001, the IRS published Notice 2001-76 (2001-52 I.R.B. 613) proposing a revenue procedure (the pro-

posed revenue procedure) that would allow qualifying small business taxpayers with average annual gross receipts of \$10 million or less to use the cash method with respect to eligible trades or businesses. Notice 2001-76 also requested comments from the public regarding the proposed revenue procedure. This announcement discusses certain issues raised by those comments and the manner in which those issues are addressed in the final revenue procedure.

The final revenue procedure appears in this Internal Revenue Bulletin as Rev. Proc. 2002-28.

#### CHANGES TO THE PROPOSED REVENUE PROCEDURE

##### *General Application of Rev. Proc. 2002-28*

Several commentators asked for assistance in understanding which taxpayers are eligible to elect the cash method under the revenue procedure. In response, a flow chart has been added as an appendix to Rev. Proc. 2002-28. This flow chart provides a short-hand explanation of the scope and application of the final revenue procedure and helps explain the interaction of the revenue procedure with other authorities (such as § 448). Taxpayers should keep in mind that it is less detailed than the actual provisions of the revenue procedure and should be used only as a guide.

Many commentators asked whether the proposed revenue procedure waives the statutory restrictions placed on the use of the cash method in § 448. Rev. Proc. 2002-28 clarifies that the provisions of § 448 are not affected by the revenue procedure.

Many commentators requested clarification of the options available to qualifying small businesses under the proposed revenue procedure in choosing their overall method of accounting as well as their method of accounting for inventoriable items. In response to this request, Rev. Proc. 2002-28 lists the three options available under the revenue procedure to qualifying small business taxpayers who choose not to use an overall accrual method and an inventory method of accounting.

#### *Determination and Qualification of a Taxpayer's Principal Business Activity*

The proposed revenue procedure allowed any taxpayer whose principal business activity is not described in a prohibited North American Industry Classification System ("NAICS") code to use the cash method for all of its trades or businesses. Several commentators expressed concern that because the proposed revenue procedure looks only to the gross receipts of the taxpayer's most recent taxable year in determining a taxpayer's principal business activity, temporary fluctuations in the nature of the taxpayer's trades or businesses could change its principal business activity for purposes of the revenue procedure and thus its continued ability to use the cash method for all of its trades or businesses. In response, the final revenue procedure adopts a two-prong principal business activity test. A taxpayer may determine its principal business activity using either (i) the gross receipts for its prior taxable year, or (ii) the average annual gross receipts for its three most recent prior taxable years.

Rev. Proc. 2002-28 also clarifies that the revenue procedure may be used only by those taxpayers who did not previously change (and were not required to have previously changed) from the cash method to an accrual method for any trade or business as a result of their trade or business becoming ineligible to use the cash method under the revenue procedure. Such taxpayers may, however, apply the revenue procedure to separate trades or businesses with complete and separable books and records that are not described in an ineligible NAICS code in section 4.01(1)(a), that are service businesses under section 4.01(1)(b), or that are custom manufacturers under section 4.01(1)(c).

A few commentators requested additional guidance regarding how the proposed revenue procedure would apply to a taxpayer in its first year of business, given that it would not have any prior year gross receipts for purposes of the principal business activity test. Rev. Proc. 2002-28 provides that a taxpayer in its first year of business may use its current year gross receipts to determine its principal business activity.

Commentators requested guidance on the interaction of the service provider safe harbor in section 4.01(1)(b) and the custom manufacturer safe harbor in section 4.01(1)(c) with the NAICS code safe harbor of section 4.01(1)(a). In response to this request, Rev. Proc. 2002–28 clarifies that a taxpayer may qualify to apply the revenue procedure to all of its trades or businesses by meeting the requirements of either the NAICS code safe harbor in section 4.01(1)(a), the service provider safe harbor in section 4.01(1)(b), or the custom manufacturer safe harbor in section 4.01(1)(c). A taxpayer’s principal business activity must qualify under only one of these three provisions for all of the taxpayer’s trades or businesses to be eligible to use the revenue procedure.

#### *Inventoriable Items Treated as Materials and Supplies that Are Not Incidental under § 1.162–3*

In Rev. Proc. 2001–10, the IRS determined that, for reasons of administrative convenience and reduction of taxpayer burden, taxpayers need not apply the uniform capitalization rules of § 263A to inventoriable items treated as non-incidental materials and supplies under § 1.162–3 for purposes of that revenue procedure. Several commentators suggested that the provisions of § 263A similarly should not apply to inventoriable items treated as non-incidental materials and supplies for purposes of the proposed revenue procedure. The IRS and Treasury Department agree with this comment and have included this provision in Rev. Proc. 2002–28.

Commentators requested additional guidance regarding when the costs of materials and supplies that are not incidental may be deducted. In response to this request, Rev. Proc. 2002–28 provides additional examples to illustrate the appropriate timing of such deductions under § 1.162–3. One of these examples clarifies that under the cash method, the cost of raw materials may not be deducted until the product is provided to the customer (the costs must be added to the basis of a manufactured item rather than currently deducted). In addition, Rev. Proc. 2002–28 clarifies that in determining the amount of the deduction for inventoriable items that are treated as non-incidental materials and supplies, the

taxpayer may use a specific identification method, a first-in, first-out (FIFO) method, or an average cost method, but that other methods, such as a last-in, first-out (LIFO) method, may not be used.

#### *Other Issues*

Several commentators requested clarification of the open accounts receivable (that is, for purposes of Rev. Proc. 2002–28, a receivable due in full in 120 days or less) rule in section 4.03 of the proposed revenue procedure. In response to this request, Rev. Proc. 2002–28 contains an additional example to illustrate the rule.

Several commentators requested additional guidance on the treatment of specific methods of accounting for particular items (such as specific methods for long-term contracts) for taxpayers using one of the options under Rev. Proc. 2002–28. In response, the final revenue procedure clarifies that taxpayers may, in some cases, be able to retain their specific method of accounting even when they use one of the options under the revenue procedure.

### **Additional Safe Harbor Explanations of Certain Qualified Plan Distributions**

#### **Announcement 2002–46**

This announcement contains a safe harbor explanation in Spanish that plan administrators can provide to Spanish-speaking employees who are recipients of eligible rollover distributions from qualified employer plans, tax-sheltered annuities or governmental § 457 plans in order to satisfy § 402(f) of the Internal Revenue Code. Previously, in Notice 2002–3 (2002–2 I.R.B. 289), the Internal Revenue Service published these safe harbor explanations in English.

#### ***EXPLICACIÓN DEL CONCEPTO DE REFUGIO TRIBUTARIO EN LOS PLANES CALIFICADOS CONFORME A LA SECCIÓN 401(a), LA SECCIÓN 403(a), PLANES DE ANUALIDADES, O LA SECCIÓN 403(b), ANUALIDADES CON PAGO DEL IMPUESTO DIFERIDO***

### ***NOTIFICACIÓN TRIBUTARIA ESPECIAL SOBRE LOS PAGOS DE PLANES***

En esta notificación se explica la forma en que usted puede continuar aplazando el pago del impuesto federal sobre el ingreso en sus ahorros de la jubilación en el [INSERTAR AQUÍ EL NOMBRE DEL PLAN] (en adelante denominado el “Plan”). La notificación contiene también una información importante que usted debe conocer antes de decidir cómo va a recibir los beneficios o pagos de su Plan.

Esta notificación se la envía a usted [INSERTAR AQUÍ EL NOMBRE DEL ADMINISTRADOR DEL PLAN O, EN EL CASO DE UNA ANUALIDAD CONFORME A LA SECCIÓN 403(b), ANUALIDADES CON PAGO DEL IMPUESTO DIFERIDO, LA ENTIDAD PAGADORA] (en adelante denominado el “Administrador del Plan”), porque toda la cantidad o parte del pago que va usted a recibir dentro de poco del Plan podría cumplir con los requisitos establecidos para una reinversión por usted o su Administrador del Plan en una cuenta IRA tradicional o en un plan patronal calificado. Una reinversión es un pago o transferencia efectuado por usted o el Administrador del Plan de todo o parte de su beneficio a otro plan o a una cuenta IRA que le permite continuar posponiendo el pago del impuesto sobre ese beneficio hasta que se le pague. Su pago no puede reinvertirse en una cuenta Roth IRA, en una cuenta SIMPLE IRA ni en una cuenta de ahorro para la educación Coverdell Education Savings Account (anteriormente conocida como cuenta IRA para educación). Un “plan patronal calificado” consiste en un plan que reúne los requisitos legales establecidos en la sección 401(a) del Código Tributario, que comprende los planes siguientes: plan 401(k) del empleador, plan de participación en los beneficios, plan de beneficios definidos, plan de acciones gratuitas y plan de contribución dineraria patronal al fondo de pensiones; un plan de anualidad de la sección 403(a), una anualidad con pago del impuesto diferido de la sección 403(b), y un plan calificado de la sección 457(b) mantenido por un empleador del gobierno (plan 457 gubernamental).

Un plan patronal calificado no está legalmente obligado a aceptar una reinversión. Antes de decidir reinvertir su pago en otro plan patronal, deberá averiguar si el plan acepta reinversiones y, en caso afirmativo, los tipos de distribuciones que acepta como reinversión. Deberá informarse también sobre los documentos requeridos que han de llenarse para que el plan receptor acepte una reinversión. Aunque un plan acepte reinversiones, podría no aceptar reinversiones de ciertos tipos de distribuciones, tales como las cantidades después de pagar los impuestos. Cuando éste sea el caso y su distribución comprenda sumas después de pagar los impuestos, usted podría en su lugar, si lo desea, reinvertir su distribución en una cuenta IRA tradicional o bien dividir la cantidad de la reinversión entre el plan patronal en el que va a participar y una cuenta IRA tradicional. Si un plan patronal acepta su reinversión, el mismo podría limitar las distribuciones posteriores de la cantidad de reinversión o requerir el consentimiento de su cónyuge para cualquier distribución posterior. Una distribución posterior del plan que acepta su reinversión podría estar también sujeta a un tratamiento tributario distinto al de las distribuciones de este Plan. Consulte con el administrador del plan que va a recibir su reinversión antes de hacer la reinversión.

Si tiene usted algunas preguntas que hacer después de leer esta notificación, puede ponerse en contacto con el Administrador de su plan [INSERTAR AQUÍ EL NÚMERO DE TELÉFONO U OTRA INFORMACIÓN DE CONTACTO].

#### RESUMEN

Hay dos maneras en que usted podría recibir un pago del Plan que reúne los requisitos exigidos para una reinversión:

(1) Ciertos pagos pueden hacerse directamente a una cuenta IRA tradicional

que usted tenga o a un plan patronal calificado que lo aceptará y mantendrá para su beneficio (“REINVERSIÓN DIRECTA”). O

#### (2) Pago HECHO A USTED.

Si usted opta por una REINVERSIÓN DIRECTA:

- Su pago no tributará en el año actual ni se le hará ninguna retención del impuesto sobre el ingreso.
- Usted decide si su pago se hará directamente a su cuenta IRA tradicional o a un plan patronal calificado que acepta su reinversión. Su pago no puede reinvertirse en una cuenta Roth IRA, una cuenta SIMPLE IRA ni en una cuenta de ahorro para educación Coverdell Education Savings Account porque éstas no son cuentas IRA tradicionales.
- La parte imponible de su pago se gravará más tarde cuando la saque de su cuenta IRA tradicional o del plan patronal calificado. Dependiendo del tipo de plan de que se trate, la distribución posterior podría estar sujeta a un tratamiento tributario diferente al que se aplicaría si usted recibiera una distribución imponible de este Plan.

Si opta por un pago HECHO A USTED del Plan que reúne los requisitos exigidos para una reinversión:

- Recibirá solamente el 80% de la cantidad imponible del pago, porque el Administrador del Plan tiene que retener el 20% de esa cantidad y enviarla al IRS como retención del impuesto sobre el ingreso para ser acreditada contra sus impuestos.
- La cantidad imponible de su pago se gravará en el año actual, a menos que la reinvierta. En ciertas circun-

stancias, usted podrá aplicar unas reglas tributarias especiales que podrían reducir el impuesto que debe. Sin embargo, si usted recibe el pago antes de cumplir 59 años y medio, tendría que pagar un impuesto adicional del 10%.

- Usted puede reinvertir todo o parte del pago, transfiriéndolo a su cuenta IRA tradicional o a un plan patronal calificado que acepte su reinversión dentro de un plazo de 60 días a partir del recibo del pago. La cantidad reinvertida no tributará hasta que usted no la saque de su cuenta IRA tradicional o del plan patronal calificado.
- Si usted desea reinvertir el 100% del pago en una cuenta IRA tradicional o en un plan patronal calificado, *tendrá que obtener el dinero de otra fuente para reponer el 20% de la parte imponible que se le retuvo*. Si reinvierte solamente el 80% del pago que recibió, tendrá que pagar impuestos sobre el 20% que se le retuvo y no se reinvierte.

*Su Derecho a Renunciar al Plazo de Notificación de 30 Días.* En general, no podrá hacerse una reinversión directa ni un pago del plan hasta 30 días, como mínimo, después de haber recibido esta notificación. Por lo tanto, después de recibir esta notificación, tendrá un plazo, como mínimo, de 30 días para pensar si va o no a reinvertir directamente su retiro. Si no quiere esperar hasta que finalice ese plazo de notificación de 30 días para la tramitación de su opción, puede renunciar al mismo, haciendo una elección afirmativa e indicando si desea o no una reinversión directa. Su retiro será entonces tramitado de acuerdo con su opción lo antes posible después de recibirla el Administrador del Plan.

#### MÁS INFORMACIÓN

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## I. PAGOS QUE PUEDEN Y QUE NO PUEDEN REINVERTIRSE

Los pagos recibidos del Plan pueden ser “distribuciones de reinversión calificadas”, o sea, que pueden reinvertirse en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Los pagos de un plan no pueden reinvertirse en una cuenta Roth IRA, una cuenta SIMPLE IRA ni en una cuenta Coverdell Education Savings Account [cuenta de ahorro para educación]. El administrador de su Plan podrá decirle qué parte de su pago es una distribución de reinversión calificada.

*Contribuciones después de pagar los impuestos.* Si usted hizo contribuciones al Plan después de pagar los impuestos, estas contribuciones pueden reinvertirse en una cuenta IRA tradicional o en ciertos planes patronales que acepten reinversiones de contribuciones después de pagar los impuestos. Se aplican las reglas siguientes:

- a) Reinversión en una cuenta IRA tradicional. Puede reinvertir sus contribuciones después de pagar los impuestos en una cuenta IRA tradicional directa o indirectamente. El administrador de su plan podrá decirle qué cantidad de su pago es la parte tributable y qué cantidad es la parte después de los impuestos.

Si reinvierte contribuciones después de pagar los impuestos en una cuenta IRA tradicional, será su responsabilidad mantener un registro, e informar al IRS en las formas correspondientes, de la cantidad de esas contribuciones después de los impuestos. Esto permitirá calcular la cantidad no tributable de cualquier distribución futura de la cuenta IRA tradicional.

Una vez realizada la reinversión de sus contribuciones después de los impuestos en una cuenta IRA tradicional, estas cantidades NO PODRÁN reinvertirse más tarde en un plan patronal.

- b) Reinversión en un Plan Patronal. Puede reinvertir contribuciones después del impuesto procedentes de un plan patronal que cumpla con los requisitos establecidos conforme

a la sección 401(a) o un plan de anualidad de la sección 403(a) del Código Tributario en otro plan semejante utilizando una reinversión directa, si este otro plan mantiene una contabilidad separada de las cantidades reinvertidas, incluida una contabilidad separada para las contribuciones del empleado después del impuesto y de los ingresos devengados en dichas contribuciones. Asimismo, puede usted reinvertir también contribuciones después del impuesto de una anualidad con pago del impuesto diferido de la sección 403(b) en otra anualidad del mismo tipo, utilizando una reinversión directa, si la otra anualidad con pago del impuesto diferido mantiene una contabilidad separada para las cantidades reinvertidas, incluida una contabilidad separada para las contribuciones del empleado después de pagar los impuestos y de los ingresos devengados en dichas contribuciones. Usted NO PUEDE reinvertir contribuciones después del impuesto en un plan 457 gubernamental. Si quiere reinvertir sus contribuciones después del impuesto en un plan patronal que acepta dichas reinversiones, no podrá ordenar que le paguen a usted primero las contribuciones después del impuesto. Tendrá que dar instrucciones al Administrador del Plan de dicho Plan para que haga una reinversión directa en su nombre. Además, usted no puede reinvertir primero contribuciones después del impuesto en una cuenta IRA tradicional y reinvertir luego esa cantidad en un plan patronal.

Los tipos de pagos que se indican a continuación *no pueden* reinvertirse:

*Pagos espaciados en períodos largos de tiempo.* No podrá reinvertir un pago si éste forma parte de una serie de pagos iguales (o casi iguales) que se hacen al menos una vez al año y que durarán:

- Toda su vida (o un período basado en su expectativa de vida). O
- Toda su vida y toda la vida de su beneficiario (o un período basado en las expectativas de vida de ambos). O

- Un período de 10 o más años.

*Pagos mínimos requeridos.* A partir de la fecha en que cumpla 70 años y medio o se jubile, la fecha que ocurra más tarde, cierta cantidad de su pago no podrá reinvertirse, porque existe un “pago mínimo requerido” que deberá hacerse a usted. Se aplican unas reglas especiales si usted posee una participación de más del 5% en la empresa de su empleador.

*Distribuciones por dificultades excepcionales.* Una distribución por dificultades excepcionales no puede reinvertirse.

*Dividendos de un plan ESOP.* Los dividendos en efectivo que usted percibe de acciones poseídas en un plan de compra de acciones para los empleados u obreros (ESOP) no pueden reinvertirse.

*Distribuciones correctivas.* Una distribución que se hace para remediar una prueba de no discriminación no satisfecha o porque los límites legales establecidos para ciertas contribuciones fueron excedidos no puede reinvertirse.

*Préstamos tratados como distribuciones.* La cuantía de un préstamo con cargo a un plan considerada una distribución tributable por incumplimiento de pago no puede reinvertirse. Sin embargo, una cuantía compensatoria del préstamo puede reinvertirse, como se explicará en la Parte III más adelante. Pregunte al Administrador del Plan de dicho Plan si la distribución de su préstamo cumple con los requisitos exigidos para tratarlo como reinversión.

El Administrador del Plan de dicho Plan podrá indicarle si su pago incluye cantidades que no pueden reinvertirse.

## II. REINVERSIÓN DIRECTA

UNA REINVERSIÓN DIRECTA es un pago directo de la cantidad de sus beneficios recibidos del Plan en una cuenta IRA tradicional o en un plan patronal calificado que lo acepte. Usted puede optar por una REINVERSIÓN DIRECTA de todo o de cualquier parte de su pago que sea una distribución de reinversión calificada, según se ha descrito anteriormente en la Parte I. Cualquier parte tributable de su pago de la que opte por una REINVERSIÓN DIRECTA se gravará más tarde cuando la saque de su cuenta

IRA tradicional o del plan patronal calificado. Además, no se requerirá hacer ninguna retención del impuesto sobre el ingreso en ninguna parte tributable de sus beneficios del Plan de la que opte por una REINVERSIÓN DIRECTA. Este plan posiblemente no le permita optar por una REINVERSIÓN DIRECTA si sus distribuciones durante el año son menos de \$200.

*REINVERSIÓN DIRECTA en una cuenta IRA tradicional.* Puede abrir una cuenta IRA tradicional para recibir la reinversión directa. Si decide que se le haga su pago directamente en una cuenta IRA tradicional, póngase en contacto con una entidad patrocinadora de una cuenta IRA (normalmente una institución financiera) para averiguar cómo se hace una reinversión directa en una cuenta IRA tradicional en esa institución. Si no está seguro de cómo invertir su dinero, puede abrir temporalmente una IRA tradicional para recibir el pago. Sin embargo, al elegir una cuenta IRA tradicional, debiera asegurarse de que la cuenta IRA tradicional que elige le permitirá transferir todo o parte de su pago a otra cuenta IRA tradicional en una fecha posterior sin penalizaciones u otras restricciones. Véase la Publicación 590, Planes de Ahorro para la Jubilación, del IRS, para obtener información adicional sobre las cuentas IRA tradicionales (incluidas las limitaciones sobre la frecuencia con que puede usted reinvertir entre cuentas IRA).

*REINVERSIÓN DIRECTA en un Plan.* Si usted trabaja para un nuevo empleador que posee un plan patronal calificado y desea hacer una reinversión directa en ese plan, pregunte al administrador del plan de ese plan si aceptará su reinversión. Un plan patronal calificado no está legalmente obligado a aceptar una reinversión. Aunque el plan de su nuevo empleador no acepte una reinversión, usted puede optar por una REINVERSIÓN DIRECTA en una cuenta IRA tradicional. Si el plan del empleador acepta su reinversión, el mismo podría poner restricciones en cuanto a las circunstancias en que usted podría recibir más tarde una distribución de la cantidad reinvertida o podría requerir el consenso del cónyuge para cualquier distribución posterior. Consulte con el administrador del plan de dicho plan antes de tomar su decisión.

*REINVERSIÓN DIRECTA de una serie de pagos.* Si usted recibe un pago que puede reinvertirse en una cuanta IRA tradicional o en un plan patronal calificado que lo acepte y se efectúa en una serie de pagos durante un plazo de menos de 10 años, su opción de hacer o no una REINVERSIÓN DIRECTA para un pago se aplicará a todos los pagos posteriores de la serie hasta que cambie su opción. Tendrá libertad para cambiar su opción respecto a cualquier pago posterior de la serie.

*Cambio del tratamiento tributario como resultado de una REINVERSIÓN DIRECTA.* El tratamiento tributario de cualquier pago del plan patronal calificado o la cuenta IRA tradicional que recibe su REINVERSIÓN DIRECTA podría ser diferente al que se aplicaría si recibiera su beneficio en una distribución tributable directamente del Plan. Por ejemplo, si usted nació antes del 1 de enero de 1936, podría tener derecho a un tratamiento en forma de prorrateo del impuesto de diez años o como ganancia de capital, como se explicará más adelante. Sin embargo, si ordena que su beneficio se le reinvierta en una anualidad con pago del impuesto diferido de la sección 403(b), un plan 457 gubernamental o una cuenta IRA tradicional en una REINVERSIÓN DIRECTA, su beneficio no podrá ya acogerse a dicho tratamiento tributario especial. Véanse más adelante las secciones tituladas “Impuesto adicional del 10% si usted no ha cumplido 59 años y medio” y “Tratamiento tributario especial si usted nació antes del 1 de enero de 1936”.

### III. PAGO HECHO A USTED

Si su pago puede reinvertirse (véase la Parte I anterior) y éste se le hace en efectivo, entonces estará sujeto a una retención del impuesto federal sobre el ingreso del 20% sobre la parte tributable (y posiblemente también a una retención del impuesto estatal). El impuesto sobre el pago se grava en el año en que lo recibe, a menos que lo reinvierta dentro de un plazo de 60 días en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Si no lo reinvierte, podrían aplicarse ciertas reglas tributarias especiales.

*Retención del impuesto sobre el ingreso:*

*Retención obligatoria.* Si cualquier parte de su pago puede reinvertirse conforme a lo establecido en la Parte I anterior y usted no opta por hacer una REINVERSIÓN DIRECTA, el Plan estará obligado por ley a retenerle el 20% de la cantidad tributable. Esta cantidad se envía al IRA como retención del impuesto sobre el ingreso. Por ejemplo, si puede reinvertir un pago tributable de \$10,000, se le pagará solamente \$8,000, porque el Plan tiene que retener \$2,000 como impuesto sobre el ingreso. Sin embargo, cuando usted prepare su declaración del impuesto sobre el ingreso para el año, salvo que haga una reinversión dentro de un plazo de 60 días (véase “Opción de reinversión de sesenta días” más adelante), tendrá que declarar la cantidad total de \$10,000 como un pago tributable del Plan. Debe declarar los \$2,000 como una retención del impuesto y se le acreditará esa cantidad contra cualquier impuesto sobre el ingreso que deba para el año. No se hará ninguna retención del impuesto sobre el ingreso si sus pagos para el año son menos de \$200.

*Retención voluntaria.* Si cualquier parte de su pago es tributable, pero no puede reinvertirse de acuerdo con lo establecido en la Parte I precedente, las reglas sobre la retención obligatoria que se han descrito anteriormente no son aplicables. En tal caso, podría elegir que no se le haga retención sobre esa parte. Si usted no hace nada, se le descontará una cantidad de esa parte de su pago en concepto de retención del impuesto federal sobre el ingreso. Para no optar por la retención, solicite al Administrador del Plan la forma de la opción y la información pertinente.

*Opción de reinversión de sesenta días.* Si recibe un pago que puede reinvertirse conforme a lo establecido en la Parte I anterior, usted podrá, no obstante, optar por reinvertir todo el pago o parte del mismo en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Si decide hacer una reinversión, *tendrá que transferir la cantidad del pago que recibió a una cuenta IRA tradicional o a un plan patronal calificado dentro de un plazo de 60 días a partir de la fecha en que recibió el pago.*

La parte de su pago que se reinvierte no se gravará hasta que usted la saque de la cuenta IRA tradicional o del plan patronal calificado.

Podrá reinvertir hasta el 100% de su pago que pueda reinvertirse conforme a lo dispuesto en la Parte I anterior, incluida una cantidad igual al 20% de la parte tributable que le fue retenida. Si opta por reinvertir el 100%, tendrá que obtener el dinero de otra parte dentro de un plazo de 60 días para contribuir a la cuenta IRA tradicional o al plan patronal calificado para reponer el 20% que se le retuvo. Por otra parte, si reinvierte solamente el 80% de la parte tributable que recibió, tendrá que pagar impuesto sobre el 20% que se le retuvo.

*Ejemplo:* La parte tributable de su pago que puede reinvertirse de acuerdo con lo establecido en la Parte I anterior es una suma de \$10,000 y puede elegir que se le pague a usted. Recibirá \$8,000, y \$2,000 se enviarán al IRS como retención del impuesto sobre el ingreso. Dentro de un plazo de 60 días de haber recibido los \$8,000, usted podrá reinvertir toda la cantidad de \$10,000 en una cuenta IRA tradicional o en un plan patronal calificado. Para ello, reinvertirá los \$8,000 que recibió del Plan y tendrá que obtener \$2,000 de otras fuentes (sus ahorros, un préstamo, etc.). En tal caso, la cantidad total de \$10,000 no tributará hasta que la saque de la cuenta IRA tradicional o del plan patronal calificado. Si reinvierte la suma total de los \$10,000, cuando presente su declaración del impuesto sobre el ingreso, podría obtener un reembolso de parte o de toda la cantidad de los \$2,000 retenidos.

Si, por otro lado, usted reinvierte solamente \$8,000, los \$2,000 que no reinvirtió tributarán en el año en que se retuvieron. Cuando presente su declaración del impuesto sobre el ingreso, podría obtener un reembolso de parte de los \$2,000 que le fueron retenidos. (Sin embargo, cualquier reembolso será probablemente mayor si reinvierte toda la cantidad de los \$10,000).

*Impuesto adicional del 10% si usted no ha cumplido 59 años y medio.* Si

recibe un pago antes de cumplir 59 años y medio y no lo reinvierte, entonces, además del impuesto ordinario sobre el ingreso, tendría que pagar un impuesto adicional igual al 10% de la parte tributable del pago. El impuesto adicional del 10% no se aplica generalmente a (1) los pagos que se hacen después de haber cesado usted de trabajar para su empleador en el año o después del año en que cumpla usted 55 años; (2) los pagos que se hacen porque se jubila por incapacidad; (3) los pagos que se hacen como pagos iguales (o casi iguales) durante su vida o expectativa de vida (o durante las vidas y expectativas de vida de usted y su beneficiario); (4) los dividendos pagados en acciones por un plan de compra de acciones para los empleados (ESOP), según se describe en la sección 404(k) del Código Tributario; (5) los pagos que se hacen directamente al gobierno para pagar un gravamen de impuesto federal; (6) los pagos que se hacen a un beneficiario sustituto conforme a una orden judicial de asuntos familiares calificada, o (7) los pagos que no exceden de la cantidad de sus gastos médicos deducibles. Véase la Forma 5329 del IRS para obtener información adicional sobre el impuesto adicional del 10% .

El impuesto adicional del 10% no se aplica a las distribuciones de un plan 457 gubernamental, salvo en la medida en que la distribución sea atribuible a una cantidad que usted reinvirtió en ese plan (ajustada para los rendimientos de la inversión) de otro tipo de plan patronal calificado o IRA. Cualquier cantidad reinvertida de un plan 457 gubernamental en otro tipo de plan patronal calificado o en una cuenta IRA tradicional estará sujeta al impuesto adicional del 10% si se le distribuye antes de cumplir usted los 59 años y medio, a menos que le sea aplicable una de las excepciones.

*“Tratamiento tributario especial si usted nació antes del 1 de enero de 1936”.* Si recibe un pago de un plan calificado conforme a la sección 401(a) o un plan de anualidad de la sección 403(a) que puede reinvertirse de acuerdo con la Parte I y no lo reinvierte en una cuenta IRA tradicional o en un plan patronal calificado, el pago tributará en el año que lo recibe. Sin embargo, si el pago se considera una “distribución en una suma glo-

bal”, podría calificarse para un tratamiento tributario especial. (Véase también “Acciones o títulos del empleador” más adelante.) La distribución en una suma global es un pago, dentro de un año, de todo su saldo en el Plan (y en otros planes patronales similares) que es pagadero a su favor después de haber cumplido 59 años y medio o porque ha cesado usted de trabajar para su empleador (o, en el caso de una persona que trabaja por cuenta propia, después de haber usted cumplido 59 años y medio o de haberse declarado incapacitado). Para que un pago pueda tratarse como una distribución en una suma global, usted tendrá que haber participado en el plan cinco años, como mínimo, antes del año en que recibió la distribución. A continuación se describe el tratamiento tributario especial para las distribuciones en una suma global que podría haber a su disposición.

*Prorrateso de diez años.* Si recibe una distribución en una suma global y nació antes del 1 de enero de 1936, podrá tomar una opción usada una sola vez para calcular el impuesto sobre el pago, utilizando el “prorrateso de 10 años” (utilizando las tasas de impuesto de 1986). El prorrateso de diez años suele reducir el impuesto que usted debe.

*Tratamiento como ganancia de capital.* Si recibe una distribución en una suma global, nació antes del 1 de enero de 1936 y participó en el Plan antes de 1974, podrá elegir que la parte de su pago atribuible a su participación anterior a 1974 en el Plan le sea tratada para efectos de los impuestos como ganancia de capital a una tasa del 20%.

Hay otras restricciones sobre el tratamiento tributario especial para las distribuciones en una suma global. Por ejemplo, usted puede generalmente optar por este tratamiento tributario especial solamente una vez durante su vida, y la opción se aplica a todas las distribuciones en una suma global que reciba en ese mismo año. Puede no elegir este tratamiento tributario especial si reinvirtió cantidades en ese Plan de un contrato de anualidad con pago del impuesto diferido de la sección 403(b), un plan 457 gubernamental o una cuenta IRA no atribuible originalmente a un plan patronal calificado. Si ha reinvertido anteriormente una distribución de dicho Plan (o de otros

planes patronales similares determinados), no podrá utilizar el tratamiento especial del prorrateo para pagos posteriores del Plan. Si reinvierte su pago en una cuenta IRA tradicional, un plan 457 gubernamental o en una anualidad con pago del impuesto diferido de la sección 403(b), no podrá utilizar el tratamiento tributario especial para pagos posteriores de esa cuenta IRA, plan o anualidad. Asimismo, si reinvierte solamente una parte de su pago en una cuenta IRA tradicional, un plan 457 gubernamental o en una anualidad con pago del impuesto diferido de la sección 403(b), no se podrá aplicar este tratamiento tributario especial al resto del pago. Véase la Forma 4972 del IRS para obtener información adicional sobre las distribuciones en una suma global y cómo puede usted elegir el tratamiento tributario especial.

*Acciones o títulos de un plan patronal.* Hay una regla especial que se aplica a un pago del Plan que incluye acciones patronales (u otros títulos patronales). Para utilizar esta regla especial, 1) el pago tiene que calificarse como distribución en una suma global, como se ha descrito ya anteriormente, salvo que usted no necesitará cinco años de participación en el plan o 2) las acciones patronales incluidas en el pago deben ser atribuibles a contribuciones del empleado u obrero “después del impuesto”, si las hubiera. De acuerdo con esa regla especial, usted puede tener la opción de no pagar impuesto sobre la “valorización no realizada neta” de las acciones hasta que las venda. La valorización no realizada neta es generalmente el incremento del valor de la acción patronal durante el tiempo en que la acción fue poseída por el Plan. Por ejemplo, si la acción patronal fue contribuida a su cuenta del Plan cuando ésta valía \$1,000, pero la acción valía \$1,200 cuando la recibió, no tendría que pagar impuesto sobre el incremento de valor de \$200 hasta que usted venda la acción posteriormente.

Usted podría, en su lugar, optar por hacer que no se aplique la regla especial a la valorización no realizada neta. En tal caso, su valorización no realizada neta se gravará en el año que reciba la acción, a menos que la reinvierta. La acción puede reinvertirse en una cuenta IRA tradicional o en otro plan patronal calificado, bien en

forma de una reinversión directa o de una reinversión que haga usted mismo. En general, no podrá ya utilizar la regla especial para la valorización no realizada neta si reinvierte la acción en una cuenta IRA tradicional o en un plan patronal calificado.

Si recibe solamente acciones de un plan patronal en un pago que puede reinvertirse, no se le retendrá ninguna cantidad del pago. Si recibe dinero efectivo u otros bienes que no sean acciones de un plan patronal, y también acciones de un plan patronal, en un pago que puede reinvertirse, la cantidad de la retención del 20% se basará en la cantidad total tributable que se le haya pagado (incluido el valor de las acciones de un plan patronal calculado excluyendo la valorización no realizada neta). Sin embargo, la cantidad retenida se limitará al efectivo o bienes recibidos (excluidas las acciones de un plan patronal) que se le hayan pagado.

Si recibe acciones de un plan patronal en un pago que se considera una distribución en una suma global, se podrá también aplicar el tratamiento tributario especial para las distribuciones en una suma global que se ha descrito anteriormente (como el prorrateo de 10 años). Véase la Forma 4972 del IRS para obtener información adicional sobre estas reglas.

*Reembolso de préstamos del Plan.* Si su empleo cesa y tiene usted un préstamo pendiente con su Plan, su empleador puede reducir (o “compensar”) su saldo en el Plan por la cuantía del préstamo que no haya pagado. La cuantía de la compensación del préstamo se trata como si fuera una distribución que se le hace a usted en el momento de la compensación y tributará, a menos que usted reinvierta una cantidad igual a la cantidad de la compensación de su préstamo en otro plan patronal calificado o en una cuenta IRA tradicional dentro de un plazo de 60 días a partir de la fecha de la compensación. Si la cantidad de la compensación de su préstamo es la única cantidad que usted recibe o se trata como si la hubiera recibido, no se le retendrá ninguna cantidad de ella. Si recibe otros pagos en efectivo o bienes del Plan, la cantidad de retención del 20% se basará en la cantidad total que se le haya pagado, incluida la cantidad de la compensación

del préstamo. La cantidad retenida se limitará a la cantidad de otros pagos en efectivos o bienes que se le hayan hecho (que no sean títulos de planes patronales). La cantidad de un préstamo del plan con incumplimiento de pago que se considere una distribución tributable no puede reinvertirse.

#### IV. CÓNYUGES SOBREVIVIENTES, BENEFICIARIOS SUSTITUTOS Y OTROS BENEFICIARIOS

En general, las reglas que se han resumido anteriormente aplicables a los pagos efectuados a los empleados se aplican también a los cónyuges sobrevivientes de los empleados y a los cónyuges o ex cónyuges que son “beneficiarios sustitutos”. Usted es un beneficiario sustituto cuando su participación en el Plan se debe a una “orden judicial de asuntos familiares especificada”, que es una orden dictada por un tribunal, normalmente en relación con un divorcio o una separación legal.

Si usted es un cónyuge sobreviviente o un beneficiario sustituto, podría optar por un pago que puede reinvertirse, como ya se ha descrito en la Parte I, efectuado en forma de REINVERSIÓN DIRECTA en una cuenta IRA tradicional o un plan patronal calificado o hecho a usted. Si hace que el pago se le haga a usted, puede quedarse con él o reinvertirlo usted mismo en una cuenta IRA tradicional o en un plan patronal calificado. Así, pues, usted tendrá las mismas opciones que las del empleado.

Si es un beneficiario que no sea un cónyuge sobreviviente o un beneficiario sustituto, no podrá optar por una reinversión directa ni reinvertir el pago usted mismo.

Si es un cónyuge sobreviviente, un beneficiario sustituto u otro beneficiario, su pago no estará normalmente sujeto al impuesto adicional del 10% que se ha descrito anteriormente en la Parte III, aunque no haya cumplido los 59½.

Si es un cónyuge sobreviviente, un beneficiario sustituto u otro beneficiario, usted podría utilizar el tratamiento tributario especial para las distribuciones en una suma global y la regla especial para los pagos que incluyen acciones de planes patronales, como ya se ha descrito en la

Parte III. Si recibe un pago por fallecimiento del empleado, usted podría tratar el pago como una distribución en una suma global si el empleado cumple con los requisitos de edad correspondientes, independientemente de si éste participó o no 5 años en el Plan.

#### **CÓMO OBTENER INFORMACIÓN ADICIONAL**

Esta notificación ofrece solamente un resumen de las reglas tributarias federales (no estatales o municipales) que podrían aplicarse a su pago. Las reglas que se han descrito anteriormente son complejas y contienen muchas condiciones y excepciones que no se han incluido en esta notificación. Por lo tanto, debiera consultar con el Administrador del Plan o con un asesor de impuestos profesional antes de obtener un pago de sus beneficios del Plan. Puede también encontrar información más específica sobre el tratamiento fiscal de los pagos percibidos de planes patronales calificados en la Publicación 575, Ingresos de Pensiones y Anualidades, y la Publicación 590, Planes de Ahorro para la Jubilación, del IRS. Estas publicaciones se pueden obtener en su oficina local del IRS, a través del sitio web de la Internet en la dirección [www.irs.gov](http://www.irs.gov) o llamando al número 1-800-TAX-FORM (1-800-829-3676).

#### **EXPLICACIÓN DEL CONCEPTO DE REFUGIO TRIBUTARIO EN LOS PLANES 457 GUBERNAMENTALES**

#### **NOTIFICACIÓN TRIBUTARIA ESPECIAL SOBRE LOS PAGOS DE PLANES**

En esta notificación se explica la forma en que usted puede continuar aplazando el pago del impuesto federal sobre el ingreso en sus ahorros de la jubilación en el [INSERTAR AQUÍ EL NOMBRE DEL PLAN] (en adelante denominado el "Plan"). La notificación contiene también una información importante que usted debe conocer antes de decidir cómo va a recibir los beneficios o pagos de su Plan.

Esta notificación se la envía a usted [INSERTAR AQUÍ EL NOMBRE DEL ADMINISTRADOR DEL PLAN] (en adelante denominado el "Administrador del Plan"), porque toda la cantidad o parte del pago que va usted a recibir dentro de poco del Plan podría cumplir con los requisitos establecidos para una rein-

versión por usted o su Administrador del Plan en una cuenta IRA tradicional o en un plan patronal calificado. Una reinversión es un pago o transferencia efectuado por usted o el Administrador del Plan de todo o parte de su beneficio a otro plan o a una cuenta IRA que le permite continuar posponiendo el pago del impuesto sobre ese beneficio hasta que se le pague. Su pago no puede reinvertirse en una cuenta Roth IRA, en una cuenta SIMPLE IRA ni en una cuenta de ahorro para la educación Coverdell Education Savings Account (anteriormente conocida como cuenta IRA para educación). Un "plan patronal calificado" consiste en un plan que reúne los requisitos legales establecidos en la sección 401(a) del Código Tributario, que comprende los planes siguientes: plan 401(k) del empleador, plan de participación en los beneficios, plan de beneficios definidos, plan de acciones gratuitas y plan de contribución dineraria patronal al fondo de pensiones; un plan de anualidad de la sección 403(a), una anualidad con pago del impuesto diferido de la sección 403(b), y un plan calificado de la sección 457(b) mantenido por un empleador del gobierno (plan 457 gubernamental). El Plan aquí es un plan 457 gubernamental.

Un plan patronal calificado no está legalmente obligado a aceptar una reinversión. Antes de decidir reinvertir su pago en otro plan patronal, deberá averiguar si el plan acepta reinversiones y, en caso afirmativo, los tipos de distribuciones que acepta como reinversión. Deberá informarse también sobre los documentos requeridos que han de llenarse para que el plan receptor acepte una reinversión. Aunque un plan acepte reinversiones, podría no aceptar reinversiones de ciertos tipos de distribuciones. Cuando éste sea el caso, usted podría en su lugar, si lo desea, reinvertir su distribución en una cuenta IRA tradicional o bien dividir la cantidad de la reinversión entre el plan patronal en el que va a participar y una cuenta IRA tradicional. Si un plan patronal acepta su reinversión, el mismo podría limitar las distribuciones posteriores de la cantidad de reinversión o requerir el consentimiento de su cónyuge para cualquier distribución posterior. Una distribución posterior del plan que acepta su reinversión podría estar también sujeta a un tratamiento tributario distinto al de

las distribuciones de este Plan. Consulte con el administrador del plan que va a recibir su reinversión antes de hacer la reinversión.

Si tiene usted algunas preguntas que hacer después de leer esta notificación, puede ponerse en contacto con el administrador de su plan [INSERTAR AQUÍ EL NÚMERO DE TELÉFONO U OTRA INFORMACIÓN DE CONTACTO].

#### **RESUMEN**

Hay dos maneras en que usted podría recibir un pago del Plan que reúne los requisitos exigidos para una reinversión:

(1) Ciertos pagos pueden hacerse directamente a una cuenta IRA tradicional que usted tenga o a un plan patronal calificado que lo aceptará y mantendrá para su beneficio ("REINVERSIÓN DIRECTA"). O

(2) Pago HECHO A USTED.

Si usted opta por una REINVERSIÓN DIRECTA:

- Su pago no tributará en el año actual ni se le hará ninguna retención del impuesto sobre el ingreso.
- Usted decide si su pago se hará directamente a su cuenta IRA tradicional o a un plan patronal calificado que acepta su reinversión. Su pago no puede reinvertirse en una cuenta Roth IRA, una cuenta SIMPLE IRA ni en una cuenta de ahorro para educación Coverdell Education Savings Account porque éstas no son cuentas IRA tradicionales.
- La parte tributable de su pago se gravará más tarde cuando la saque de su cuenta IRA tradicional o del plan patronal calificado. Dependiendo del tipo de plan de que se trate, la distribución posterior podría estar sujeta a un tratamiento tributario diferente al que se aplicaría si usted recibiera una distribución tributable de este Plan.

Si opta por un pago HECHO A USTED del Plan que reúne los requisitos exigidos para una reinversión:

- Recibirá solamente el 80% de la cantidad tributable del pago, porque

el Administrador del Plan tiene que retener el 20% de esa cantidad y enviarla al IRS como retención del impuesto sobre el ingreso para ser acreditada contra sus impuestos.

- La cantidad tributable de su pago se gravará en el año actual, a menos que la reinvierta.
- Usted puede reinvertir todo o parte del pago, transfiriéndolo a su cuenta IRA tradicional o a un plan patronal calificado que acepte su reinversión dentro de un plazo de 60 días a partir del recibo del pago. La cantidad reinvertida no tributará hasta

que usted no la saque de su cuenta IRA tradicional o del plan patronal calificado.

- Si usted desea reinvertir el 100% del pago en una cuenta IRA tradicional o en un plan patronal calificado, *tendrá que obtener el dinero de otra fuente para reponer el 20% de la parte tributable que se le retuvo*. Si reinvierte solamente el 80% del pago que recibió, tendrá que pagar impuestos sobre el 20% que se le retuvo y no se reinvierte.

*Su Derecho a Renunciar al Plazo de Notificación de 30 Días.* En general, no

podrá hacerse una reinversión directa ni un pago del plan hasta 30 días, como mínimo, después de haber recibido esta notificación. Por lo tanto, después de recibir esta notificación, tendrá un plazo, como mínimo, de 30 días para pensar si va o no a reinvertir directamente su retiro. Si no quiere esperar hasta que finalice ese plazo de notificación de 30 días para la tramitación de su opción, puede renunciar al mismo, haciendo una elección afirmativa e indicando si desea o no una reinversión directa. Su retiro será entonces tramitado de acuerdo con su opción lo antes posible después de recibirla el Administrador del Plan.

### MÁS INFORMACIÓN

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II.	<i>REINVERSIÓN DIRECTA</i> .....	[ ]
III.	<i>PAGO HECHO A USTED</i> .....	[ ]
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#### I. PAGOS QUE PUEDEN Y QUE NO PUEDEN REINVERTIRSE

Los pagos recibidos del Plan pueden ser “distribuciones de reinversión calificadas”, o sea, que pueden reinvertirse en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Los pagos de un plan no pueden reinvertirse en una cuenta Roth IRA, una cuenta SIMPLE IRA ni en una cuenta de ahorro para educación Coverdell Education Savings Account. El administrador de su Plan podrá decirle qué parte de su pago es una distribución de reinversión calificada.

Los tipos de pagos que se indican a continuación *no pueden* reinvertirse:

*Pagos espaciados en períodos largos de tiempo.* No podrá reinvertir un pago si éste forma parte de una serie de pagos iguales (o casi iguales) que se hacen al menos una vez al año y que durarán:

- Toda su vida (o un período basado en su expectativa de vida). O
- Toda su vida y toda la vida de su beneficiario (o un período basado en las expectativas de vida de ambos). O
- Un período de 10 o más años.

*Pagos mínimos requeridos.* A partir de la fecha en que cumpla 70 años y medio o se jubile, la fecha que ocurra más tarde, cierta cantidad de su pago no podrá reinvertirse, porque existe un “pago mínimo requerido” que deberá hacerse a usted.

*Distribuciones por casos de emergencia imprevistos.* Una distribución por un caso de emergencia imprevisto no puede reinvertirse.

*Distribuciones de contribuciones excesivas.* Una distribución que se hace por que se han excedido los límites legales establecidos para ciertas contribuciones no puede reinvertirse.

*Préstamos tratados como distribuciones.* La cuantía de un préstamo con cargo a un plan considerada una distribución tributable por incumplimiento de pago no puede reinvertirse. Sin embargo, una cuantía compensatoria del préstamo puede reinvertirse, como se explicará en la Parte III más adelante. Pregunte al Administrador del Plan de dicho Plan si la distribución de su préstamo cumple con los requisitos exigidos para tratarlo como reinversión.

El Administrador del Plan de dicho Plan podrá indicarle si su pago incluye cantidades que no pueden reinvertirse.

#### II. REINVERSIÓN DIRECTA

UNA REINVERSIÓN DIRECTA es un pago directo de la cantidad de sus beneficios recibidos del Plan en una cuenta IRA tradicional o en un plan patronal calificado que lo acepte. Usted puede optar por una REINVERSIÓN DIRECTA de todo o de cualquier parte de su pago que sea una distribución de reinversión calificada, según se ha descrito anteriormente en la Parte I. Cualquier parte tributable de su pago de la que opte por una REINVERSIÓN DIRECTA se gravará más tarde cuando la saque de su cuenta IRA tradicional o del plan patronal calificado. Además, no se requerirá hacer ninguna retención del impuesto sobre el ingreso en ninguna parte tributable de sus beneficios del Plan de la que opte por una REINVERSIÓN DIRECTA. Este plan posiblemente no le permita optar por una REINVERSIÓN DIRECTA si sus distribuciones durante el año son menos de \$200.

*REINVERSIÓN DIRECTA en una cuenta IRA tradicional.* Puede abrir una cuenta IRA tradicional para recibir la reinversión directa. Si decide que se le haga su pago directamente en una cuenta IRA tradicional, póngase en contacto con una entidad patrocinadora de una cuenta

IRA (normalmente una institución financiera) para averiguar cómo se hace una reinversión directa en una cuenta IRA tradicional en esa institución. Si no está seguro de cómo invertir su dinero, puede abrir temporalmente una IRA tradicional para recibir el pago. Sin embargo, al elegir una cuenta IRA tradicional, debiera asegurarse de que la cuenta IRA tradicional que elige le permitirá transferir todo o parte de su pago a otra cuenta IRA tradicional en una fecha posterior sin penalizaciones u otras restricciones. Véase la Publicación 590, Planes de Ahorro para la Jubilación, del IRS, para obtener información adicional sobre las cuentas IRA tradicionales (incluidas las limitaciones sobre la frecuencia con que puede usted reinvertir entre cuentas IRA).

**REINVERSIÓN DIRECTA en un Plan.** Si usted trabaja para un nuevo empleador que posee un plan patronal calificado y desea hacer una reinversión directa en ese plan, pregunte al administrador del plan de ese plan si aceptará su reinversión. Un plan patronal calificado no está legalmente obligado a aceptar una reinversión. Aunque el plan de su nuevo empleador no acepte una reinversión, usted puede optar por una REINVERSIÓN DIRECTA en una cuenta IRA tradicional. Si el plan del empleador acepta su reinversión, el mismo podría poner restricciones en cuanto a las circunstancias en que usted podría recibir más tarde una distribución de la cantidad reinvertida o podría requerir el consenso del cónyuge para cualquier distribución posterior. Consulte con el administrador del plan de dicho plan antes de tomar su decisión.

**REINVERSIÓN DIRECTA de una serie de pagos.** Si usted recibe un pago que puede reinvertirse en una cuenta IRA tradicional o en un plan patronal calificado que lo acepte y se efectúa en una serie de pagos durante un plazo de menos de 10 años, su opción de hacer o no una REINVERSIÓN DIRECTA para un pago se aplicará a todos los pagos posteriores de la serie hasta que cambie su opción. Tendrá libertad para cambiar su opción respecto a cualquier pago posterior de la serie.

**Cambio del tratamiento tributario como resultado de una REINVERSIÓN DIRECTA.** El tratamiento tributario de cualquier pago del plan patronal califi-

cado o la cuenta IRA tradicional que recibe su REINVERSIÓN DIRECTA podría ser diferente al que se aplicaría si recibiera su beneficio en una distribución tributable directamente del Plan. Véase más adelante la sección titulada “Impuesto adicional del 10% que puede aplicarse a ciertas distribuciones”.

### III. PAGO HECHO A USTED

Si su pago puede reinvertirse (véase la Parte I anterior) y éste se le hace en efectivo, entonces estará sujeto a una retención del impuesto federal sobre el ingreso del 20% sobre la parte tributable (y posiblemente también a una retención del impuesto estatal). El impuesto sobre el pago se grava en el año en que lo recibe, a menos que lo reinvierta dentro de un plazo de 60 días en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Si no lo reinvierte, podrían aplicarse ciertas reglas tributarias especiales.

**Retención del impuesto sobre el ingreso:**

**Retención obligatoria.** Si cualquier parte de su pago puede reinvertirse conforme a lo establecido en la Parte I anterior y usted no opta por hacer una REINVERSIÓN DIRECTA, el Plan estará obligado por ley a retenerle el 20% de la cantidad tributable. Esta cantidad se envía al IRA como retención del impuesto federal sobre el ingreso. Por ejemplo, si puede reinvertir un pago tributable de \$10,000, se le pagará solamente \$8,000, porque el Plan tiene que retener \$2,000 como impuesto sobre el ingreso. Sin embargo, cuando usted prepare su declaración del impuesto sobre el ingreso para el año, salvo que haga una reinversión dentro de un plazo de 60 días (véase “Opción de reinversión de sesenta días” más adelante), tendrá que declarar la cantidad total de \$10,000 como un pago tributable del Plan. Debe declarar los \$2,000 como una retención del impuesto y se le acreditará esa cantidad contra cualquier impuesto sobre el ingreso que deba para el año. No se hará ninguna retención del impuesto sobre el ingreso si sus pagos para el año son menos de \$200.

**Retención voluntaria.** Si cualquier parte de su pago es tributable, pero no puede reinvertirse de acuerdo con lo establecido en la Parte I precedente, las

reglas sobre la retención obligatoria que se han descrito anteriormente no son aplicables. En tal caso, podría elegir que no se le haga retención sobre esa parte. Si usted no hace nada, se le descontará una cantidad de esa parte de su pago en concepto de retención del impuesto federal sobre el ingreso. Para no optar por la retención, solicite al Administrador del Plan la forma de la opción y la información pertinente.

**Opción de reinversión de sesenta días.** Si recibe un pago que puede reinvertirse conforme a lo establecido en la Parte I anterior, usted podrá, no obstante, optar por reinvertir todo el pago o parte del mismo en una cuenta IRA tradicional o en un plan patronal calificado que acepte reinversiones. Si decide hacer una reinversión, *tendrá que transferir la cantidad del pago que recibió a una cuenta IRA tradicional o a un plan patronal calificado dentro de un plazo de 60 días a partir de la fecha en que recibió el pago.* La parte de su pago que se reinvierte no se gravará hasta que usted la saque de la cuenta IRA tradicional o del plan patronal calificado.

Podrá reinvertir hasta el 100% de su pago que pueda reinvertirse conforme a lo dispuesto en la Parte I anterior, incluida una cantidad igual al 20% de la parte tributable que le fue retenida. Si opta por reinvertir el 100%, tendrá que obtener el dinero de otra parte dentro de un plazo de 60 días para contribuir a la cuenta IRA tradicional o al plan patronal calificado para reponer el 20% que se le retuvo. Por otra parte, si reinvierte solamente el 80% de la parte tributable que recibió, tendrá que pagar impuesto sobre el 20% que se le retuvo.

**Ejemplo:** Su pago que puede reinvertirse de acuerdo con lo establecido en la Parte I anterior es una suma de \$10,000 y puede elegir que se le pague a usted. Recibirá \$8,000, y \$2,000 se enviarán al IRS como retención del impuesto sobre el ingreso. Dentro de un plazo de 60 días de haber recibido los \$8,000, usted podrá reinvertir toda la cantidad de \$10,000 en una cuenta IRA tradicional o en un plan patronal calificado. Para ello, reinvertirá los \$8,000 que recibió del Plan y tendrá que obtener \$2,000 de otras fuentes (sus ahorros, un préstamo, etc.). En tal

caso, la cantidad total de \$10,000 no tributará hasta que la saque de la cuenta IRA tradicional o del plan patronal calificado. Si reinvierte la suma total de los \$10,000, cuando presente su declaración del impuesto sobre el ingreso, podría obtener un reembolso de parte o de toda la cantidad de los \$2,000 retenidos.

Si, por otro lado, usted reinvierte solamente \$8,000, los \$2,000 que no reinvirtió tributarán en el año en que se retiraron. Cuando presente su declaración del impuesto sobre el ingreso, podría obtener un reembolso de parte de los \$2,000 que le fueron retenidos. (Sin embargo, cualquier reembolso será probablemente mayor si reinvierte toda la cantidad de los \$10,000).

*Impuesto adicional del 10% que puede aplicarse a ciertas distribuciones.* Las distribuciones que se reciben de este Plan no están generalmente sujetas al impuesto adicional del 10% que se aplica a distribuciones de otros tipos de planes antes de cumplir 59 años y medio. Sin embargo, cualquier distribución que sea atribuible a una cantidad que usted reinvirtió en el Plan (ajustada para los rendimientos de la inversión) de otro tipo de plan patronal calificado o de una cuenta IRA estará sujeta al impuesto adicional del 10% si se le distribuye antes de cumplir usted los 59 años y medio, a menos que le sea aplicable una de las excepciones.

Las excepciones al impuesto adicional del 10% son generalmente (1) los pagos que se hacen como pagos iguales (o casi iguales) durante su vida o expectativa de vida (o durante las vidas y expectativas de vida de usted y su beneficiario); (2) los pagos que se hacen de un plan patronal calificado después de haber cesado usted de trabajar para su empleador en el año o después del año en que cumpla usted 55 años; (3) los pagos que se hacen porque se jubila por incapacidad; (4) los pagos que se hacen directamente al gobierno para pagar un gravamen de impuesto federal; (5) los pagos que se hacen a un beneficiario sustituto conforme a una orden judicial de asuntos familiares calificada, o (6) los pagos que no exceden de la cantidad de sus gastos médicos deducibles. Estas excepciones podrían ser diferentes

para las distribuciones de una cuenta IRA tradicional. Véase la Forma 5329 del IRS para obtener información adicional sobre el impuesto adicional del 10%.

El impuesto adicional del 10% no se aplica a las distribuciones del Plan o de cualquier otro plan 457 gubernamental, salvo en la medida en que la distribución sea atribuible a una cantidad que usted reinvirtió en el plan 457 gubernamental (ajustada para los rendimientos de la inversión) de otro tipo de plan patronal calificado o de una cuenta IRA.

Asimismo, cualquier cantidad reinvertida del Plan en cualquier otro tipo de plan patronal calificado o en una cuenta IRA tradicional estará sujeta al impuesto adicional del 10% si se le distribuye antes de cumplir usted los 59 años y medio, a menos que le sea aplicable una de las excepciones.

*Reembolso de préstamos del Plan.* Si su empleo cesa y tiene usted un préstamo pendiente con su Plan, su empleador puede reducir (o “compensar”) su saldo en el Plan por la cuantía del préstamo que no haya pagado. La cuantía de la compensación del préstamo se trata como si fuera una distribución que se le hace a usted en el momento de la compensación y tributará, a menos que usted reinvierta una cantidad igual a la cantidad de la compensación de su préstamo en otro plan patronal calificado o en una cuenta IRA tradicional dentro de un plazo de 60 días a partir de la fecha de la compensación. Si la cantidad de la compensación de su préstamo es la única cantidad que usted recibe o se trata como si la hubiera recibido, no se le retendrá ninguna cantidad de ella. Si recibe otros pagos en efectivo o bienes del Plan, la cantidad de retención del 20% se basará en la cantidad total que se le haya pagado, incluida la cantidad de la compensación del préstamo. La cantidad retenida se limitará a la cantidad de otros pagos en efectivos o bienes que se le hayan hecho. La cantidad de un préstamo del plan con incumplimiento de pago que se considere una distribución tributable no puede reinvertirse.

**IV. CÓNYUGES SOBREVIVIENTES, BENEFICIARIOS SUSTITUTOS Y OTROS BENEFICIARIOS**

En general, las reglas que se han resumido anteriormente aplicables a los pagos efectuados a los empleados se aplican también a los cónyuges sobrevivientes de los empleados y a los cónyuges o ex cónyuges que son “beneficiarios sustitutos”. Usted es un beneficiario sustituto cuando su participación en el Plan se debe a una “orden judicial de asuntos familiares especificada”, que es una orden dictada por un tribunal, normalmente en relación con un divorcio o una separación legal.

Si usted es un cónyuge sobreviviente o un beneficiario sustituto, podría optar por un pago que puede reinvertirse, como ya se ha descrito en la Parte I, efectuado en forma de REINVERSIÓN DIRECTA en una cuenta IRA tradicional o en un plan patronal calificado o hecho a usted. Si hace que el pago se le haga a usted, puede quedarse con él o reinvertirlo usted mismo en una cuenta IRA tradicional o en un plan patronal calificado. Así, pues, usted tendrá las mismas opciones que las del empleado.

Si es un beneficiario que no sea un cónyuge sobreviviente o un beneficiario sustituto, no podrá optar por una reinversión directa ni reinvertir el pago usted mismo.

Si es un cónyuge sobreviviente, un beneficiario sustituto u otro beneficiario, su pago no estará normalmente sujeto al impuesto adicional del 10% que se ha descrito anteriormente en la Parte III, aunque no haya cumplido los 59%.

#### **CÓMO OBTENER INFORMACIÓN ADICIONAL**

Esta notificación ofrece solamente un resumen de las reglas tributarias federales (no estatales o municipales) que podrían aplicarse a su pago. Las reglas que se han descrito anteriormente son complejas y contienen muchas condiciones y excepciones que no se han incluido en esta notificación. Por lo tanto, debiera consultar con el Administrador del Plan o con un asesor de impuestos profesional antes de obtener un pago de sus beneficios del Plan. Puede también encontrar información más específica sobre el tratamiento fiscal de los pagos percibidos de planes patronales calificados en la Publicación 575, Ingresos de Pensiones y Anualidades, y la Publicación 590, Planes de

Ahorro para la Jubilación, del IRS. Estas publicaciones se pueden obtener en su oficina local del IRS, a través del sitio web de la Internet en la dirección [www.irs.gov](http://www.irs.gov) o llamando al número 1-800-TAX-FORM (1-800-829-3676).

## Comments Requested on Possible Amendments to Regulations Governing Chapter 42 Excise Taxes

### Announcement 2002-47

The purpose of this announcement is to solicit comments addressing whether several regulations under Chapter 42 should be revised with respect to excise taxes imposed on foundation and organization managers to conform to recently-issued final regulations under section 4958 of the Internal Revenue Code (T.D. 8978, 67 Fed. Reg. 3076; 2002-7 I.R.B. 500). Section 4958 imposes taxes on any transaction that provides excess economic benefits to a person in a position to exercise substantial influence over the affairs of a public charity or a social welfare organization. Under section 4958, taxes are imposed both on the disqualified person who benefits from an excess benefit transaction and any organization manager who knowingly participates in an excess benefit transaction, unless the participation is not willful and is due to reasonable cause. The structure of these section 4958 taxes is similar to excise taxes imposed under Chapter 42 on certain transactions involving private foundations.

The final regulations under section 4958 published in January 2002 provide that an organization manager's participation in an excess benefit transaction will ordinarily not be considered knowing to the extent that, after full disclosure of the factual situation to an appropriate professional, the organization manager relies on a reasoned written opinion of that professional with respect to elements of the transaction within the professional's expertise. For this purpose, appropriate professionals are legal counsel (including in-house counsel), certified public accountants or accounting firms with expertise regarding the relevant tax law matters, and independent valuation experts who meet specified requirements.

The requirements for appropriate valuation experts are modeled after the section 170 regulations that define *qualified appraisers* for charitable deduction purposes. Under the section 4958 regulations, the valuation experts must hold themselves out to the public as appraisers or compensation consultants; perform the relevant valuations on a regular basis; be qualified to make valuations of the type of property or services being valued; and include in the written opinion a certification that they meet the preceding requirements. See Treas. Reg. § 53.4958-1(d)(4)(iii). Organization managers may seek the opinion of such an expert to help determine whether the economic benefit provided to a disqualified person in a particular transaction represents fair market value (or reasonable compensation).

Like section 4958, sections 4941 (taxes on private foundation self-dealing), 4944 (taxes on investments which jeopardize a private foundation's exempt purposes), 4945 (taxes on taxable expenditures by private foundations), and 4955 (taxes on political expenditures of section 501(c)(3) organizations) also impose excise taxes on foundation managers or organization managers who knowingly participate in transactions prohibited under those sections, unless the participation is not willful and is due to reasonable cause. The regulations under each section contain a safe harbor for managers who disclose the factual situation to legal counsel and rely on a reasoned written legal opinion that the particular transaction is not a prohibited transaction. In such cases, the participation of the manager will not ordinarily be considered "knowing" or "willful", and will ordinarily be considered "due to reasonable cause". See Treas. Reg. § 53.4941(a)-1(b)(6); § 53.4944-1(b)(2)(v); § 53.4945-1(a)(2)(vi); § 53.4955-1(b)(7). Treasury Regulation § 53.4944-1(b)(2)(v) provides an additional safe harbor with respect to taxes on jeopardizing investments, where the foundation manager makes full disclosure to a qualified investment counsel and relies on the advice of such counsel. In that instance, the advice must be derived in a manner consistent with generally accepted practices of persons who are qualified investment counsel, and the opinion that a particular investment will provide for the

long and short term financial needs of the foundation must be expressed in writing. Treas. Reg. § 53.4944-1(b)(2)(v).

In connection with the section 4958 regulation project, some commentators suggested that the "advice of counsel" safe harbors contained in regulations under section 4941 (self-dealing) and section 4945 (taxable expenditures) be expanded to parallel the safe harbor for reliance on professional advice contained in the section 4958 regulations. Like section 4958, both sections 4941 and 4945 raise issues relating to the reasonableness of compensation.

Under section 4941, taxes are imposed on acts of self-dealing between a private foundation and its disqualified persons. Although most transactions between a private foundation and its disqualified persons are absolutely prohibited, section 4941 provides an exception for the payment of compensation for personal services that are reasonable and necessary to the foundation's exempt purposes, if the compensation is not excessive. See section 4941(d)(2)(E); Treas. Reg. § 53.4941-3(c)(1).

Section 4945 imposes taxes on taxable expenditures by private foundations, including any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B) (which lists exempt purposes of section 501(c)(3) organizations). Reasonable compensation may be an issue under section 4945 in connection with the standards for permitted administrative expenses. See Treas. Reg. § 53.4945-6(b).

By contrast, section 4944 (jeopardizing investments) and section 4955 (political expenditures) do not involve fair market value or reasonable compensation issues.

The section 4958 regulation project did not undertake any revisions to the advice of counsel safe harbors in other regulations under chapter 42. At this time, the IRS and the Treasury Department request comments on the issue of whether conforming revisions to the rules contained in the section 4958 regulations are appropriate or advisable in the case of any or all of the chapter 42 regulations mentioned above. Please send your comments addressing this issue, as well as comments addressing other areas of

Chapter 42 regulations that may need updating, to the following address by August 6, 2002, referencing Announcement 2002-47:

Internal Revenue Service  
CC:ITA:RU, Room 5228  
1111 Constitution Ave., N.W.  
Washington, DC 20224

The principal author of this announcement is Phyllis D. Haney of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this announcement, contact Phyllis D. Haney at (202) 622-4290 (not a toll-free call).

## Foundations Status of Certain Organizations

### Announcement 2002-50

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:

55 Whipple Street Housing Development Fund, Brooklyn, NY  
Adult Care Philanthropic Corporation, Roseburg, OR  
African-Americans With Disabilities, Wilkinsburg, PA  
Algonquin Casino Management, Inc., Springfield, MA  
All Children's Assistance Fund, Tustin, CA  
All-Together, Inc., Westborough, MA  
Alliance for Recovery, Seattle, WA

American Association Affirmative Action Educational Foundation, Indianapolis, IN  
American Disabled and Senior Citizens, Inc., Shawnee Mission, KS  
American Friends of Manchelay Torah, Inc., Chicago, IL  
American Indian Festival, Inc., Cleveland, OH  
American Museum of Asmat Art, St. Paul, MN  
Amish Innerlight Ministries, Sugar Creek, OH  
Andre Sobel River of Life Foundation, Beverly Hills, CA  
Animal Refuge Keepers, Inc., North Augusta, SC  
ARC Community Housing Opportunities, Inc., Manville, NJ  
Artists Collaborative, Minneapolis, MN  
Association of Skateboarders in Hawaii, Kailua, HI  
August Ensemble Theatre, Inc., River Forest, IL  
Baldwinsville Masonic Historical Society, Baldwinsville, NY  
Behavioral Health Improvement and Developmental Assistance, Tucson, AZ  
B G C, Inc., Brentwood, TN  
Big E. Elvin Hayes Foundation, Crosby, TX  
Brunswick Trenton Housing Corporation, Clinton, NJ  
California Association of American Physicians & Surgeons Educational, Torrance, CA  
Caring for the Hills, Chino Hills, CA  
Carmelites of the Sacred Heart and the Immaculate Heart, Steubenville, OH  
Carroll Community Development Association, Inc., Lakeland, FL  
Cavaliers Booster Club, Inc., Cherry Hill, NJ  
Center for Intercultural Harmony, Minneapolis, MN  
Chance Connection, Las Vegas, NV  
Charlotte Dare Advisory Board, Charlotte, MI  
Chestertown Housing Foundation, Inc., Chestertown, MD  
Chestnut Knolls Aviation Foundation, Inc., London, KY  
Chicago Endowment for the Arts, Chicago, IL  
Chicago Fine Arts Society, Chicago, IL  
Child and Adult Development Center of Houston, Inc., Houston, TX  
Children's Aids Foundation, Inc., Binghamton, NY

Childrens Health Foundation, Inc., Beachwood, NJ  
Childrens Place Housing Corporation-Childrens Place Association, Chicago, IL  
Chillicothe-Ross Community Foundation, Inc., Chillicothe, OH  
Cincinnati Consortium for Family Development, Inc., Cincinnati, OH  
Cleveland Club of the National Association of Negro Business & Prof., Shaker Heights, OH  
Community Housing Corporation, Kamuela, HI  
Community Resource and Development Co., Naperville, IL  
Community Youth Home Corp. of Forsyth County Mental Health, Raleigh, NC  
Comprehensive Innovations Institute, Tampa, FL  
Computer Programming Institute, Bedminster, NJ  
Consumers Mental Health Services of Ashtabula County, Inc., Ashtabula, OH  
Core Heights, Rapid City, SD  
Coronado Teen Club, Inc., Coronado, CA  
Corporation for Public Information, Tallmadge, OH  
Crime Victims Foundation, Inc., Temple City, CA  
Dance Educators Coalition of Minn., St. Paul, MN  
Deixis Publishing Foundation, Inc., Pittsburgh, PA  
Depressive and Manic Depressive Association of the Leigh Valley, Allentown, PA  
Detweiler Corporation, Clifton Park, NY  
Dilley Community Assistance Corporation, Dilley, TX  
District 34 Educational Foundation, Antioch, IL  
Donald J. Doody Foundation, Hinsdale, IL  
Dover Exchange Club Childrens Foundation, Dover, OH  
Dyna-Tek Corporation International, Fresno, CA  
E.J. Morris Senior Citizen Community Outreach Center, Inc., New Orleans, LA  
East Orange L.L. Sports, Inc. East Orange, NJ  
Ella and Robert Ridley Scholarship Foundation, Inc., Winston-Salem, NC

Empowerment Foundation,  
Memphis, TN

Enchantment Productions, Inc.,  
Wrightwood, CA

Fallbrook Chorale, Fallbrook, CA

Family Learning Tree, Inc., Decatur, GA

Feather, Riverside, CA

Flare, Inc., Flemington, NJ

FLS, Inc., Laurens, SC

Forest Meadows East Resident  
Management Corp., Jacksonville, FL

Fort Pocahontas, Ltd., Charles City, VA

Foundation for Independent American  
Schools World Wide, Evanston, IL

Freedom Educational Foundation,  
Hudsonville, MI

Friends of Arts Education,  
Golden Valley, MN

Friends of Historic New Salem, Inc.,  
New Salem, MA

Friends of Joseph & Sarah Levy Senior  
Center, Bolingbrook, IL

Friends of Oyler Foundation,  
Cincinnati, OH

Friends of the James R. Leonard  
Community Center, Port Huron, MI

Friends of the Madison School Forest,  
Inc., Madison, WI

Generations Youth and Family Services,  
Flint, MI

Genesee Oneida Housing Opportunities,  
Utica, NY

George Cook Jr. Memorial Supplemental  
Educational Library Facility,  
Philadelphia, PA

Glencoe Educational Foundation,  
Glencoe, IL

Glendale Eruv, Inc., Glendale, WI

Global Technology Exchange  
Foundation, Incorporated,  
Pennington, NJ

Good News Fellowship, Ketchikan, AK

Grafton Improvement Foundation, Inc.,  
Grafton, WI

Greater Princeton Steinway Society, Inc.,  
Princeton, NJ

Green Mountain Foundation,  
Houston, TX

Hand-N-Hand Creations, Inc.,  
Binghamton, NY

Harrisburg Mayors Commission on  
Literacy, Harrisburg, PA

Hemophilia Outreach of Wisconsin, Inc.,  
Green Bay, WI

Heritage House Group Home,  
Columbus, OH

Highland Rim Rural Housing Assistance,  
McMinnville, TN

Holland Public Schools-Holland Band  
Parents Association, Holland, MI

Homeless Care Foundation, Inc.,  
Feasterville, PA

Holmes Counseling Center,  
Carbondale, IL

Hoot Owl Servants Corporation,  
Spokane, WA

Hope House, Chicago, IL

Hopewell Valley Soccer Club,  
Pennington, NJ

Hudson Consulting for Social Services,  
Inc., North Bergen, NJ

Huntington Community Strings, Inc.,  
Huntington, IN

Institute of Alternative Healing,  
Pacific Palisades, CA

Institute of World Traditional Medicine,  
San Francisco, CA

International Center for Law Trade and  
Diplomacy, Inc., Rye Brook, NY

International Foundation for Mental  
Health and Neurosciences, Inc.,  
Potomac, MD

Interpreters of Southern California, Inc.,  
Riverside, CA

Irish-American Heritage Foundation of  
Central New York, Inc., Syracuse, NY

Jackson Community Services,  
Chicago, IL

Job Connection, Inc., Whittier, CA

John J. Wagner Ministries, Inc.,  
Cooper City, FL

Jubilee Foundation, Prescott, WA

Just for Kids Education Foundation,  
Bensalem, Pa

Kankakee Track Club, Kankakee, IL

Kevin J. Lehnert Scholarship Trust Fund,  
Crestwood, IL

Kick-Off, Palmdale, CA

Kids Citizenship Foundation,  
Chicago, IL

Kids Help Foundation, Schaumburg, IL

Kids Voting Michigan, Detroit, MI

Kingdom Harvest Ministries,  
Escondido, CA

Kiwanis Foundation of Table Rock,  
Central Point, OR

Kora Filmworks, Berkeley, CA

La Crescent Foundation, Inc.,  
La Crescent, MN

Lady of Grace Room & Board,  
Riverside, CA

Lakota Foundation, W. Chester, OH

Lao Parent-Student-Teacher Association,  
San Diego, CA

Laurel Highlands Academic Foundation,  
Uniontown, PA

Learning Immune Function  
Enhancement Foundation,  
San Francisco, CA

Lifecircles Unlimited, Inc.,  
Granada Hills, CA

Lolly Cohen Foundation, Inc.,  
Virginia Beach, VA

Maryland Educational Media  
Organization, Inc., Queenstown, MD

Meals on Wheels Fund, Inc.,  
Madison, WI

Medical and Scientific Information  
Online, Inc., Indianapolis, IN

Methuen Community Television Corp.,  
Methuen, MA

Michael P. Corrigan Memorial  
Scholarship Fund, Poughkeepsie, NY

Milwaukee Concert Band, Inc.,  
Elm Grove, WI

Minnesota Chapter Federal Bar  
Association Foundation,  
Minneapolis, MN

Minuteman Institute for National  
Defense Studies, Alexandria, VA

Mississippi Union Club USA,  
Incorporated, Indianapolis, IN

Moshannon Valley Parent Teacher  
Organization, Houtzdale, PA

Nanston Educational Foundation, Inc.,  
Norcross, GA

National Organization for Water  
Awareness, Wallingford, CT

National Sports Concepts, Inc.,  
Canton, OH

Naturelands Project, San Diego, CA

New Directions Treatment Center,  
Danville, IL

New Images, Inc., Pine Bluff, AR

New Jersey Coalition for Inclusive  
Education, Inc., Turnersville, NJ

New Vision Enterprises, Inc.,  
South Pasadena, CA

N F A Crew Booster Club, Inc.,  
Newburgh, NY

Noeticus, Plymouth, MN

North Bergen Urban Enterprise Zone  
Development Corporation,  
W. Caldwell, NJ

North Caldwell Hoops, Inc.,  
North Caldwell, NJ

North Philadelphia Financial Partnership,  
Philadelphia, PA

North Star Academy, Philadelphia, PA

Northeast Homeownership Consortium,  
Inc., Oklahoma City, OK

Northern Kentucky School-to-Work  
Partnership, Inc., Covington, KY

Nueva Esperanza-Camden, Inc.,  
Camden, NJ

Old Bridge Youth Hockey Association, Inc., Hazlet, NJ  
 Omega Phi Alpha Scholarship Fund Trust, Fort Worth, TX  
 Our Lady of Fatima Society of Holy Cross of Harrison, Inc., Harrison, NJ  
 Our World of Learning, West Mifflin, PA  
 Parents and Community Together of Northeast Cincinnati, Maineville, OH  
 Parents Association, Westerville, OH  
 Park Forest Community Development Corporation, Park Forest, IL  
 Parkvision 98, Belleville, IL  
 Partnership FPR Families, Inc., Richmond, VA  
 Paseo Gratis Foundation, San Antonio, TX  
 Pass It On, Montclair, NJ  
 Penn-Harris-Madison Educational Foundation, Inc., Mishawaka, IN  
 Pennsylvania Coalition to Prevent Teen Pregnancy, Harrisburg, PA  
 Philadelphia Festival Ballet, Princeton, NJ  
 Pinelands Chronically Ill Childrens Fund, Inc., Little Egg Harbor, NJ  
 Pipsqueaks, Inc., Pittsburgh, PA  
 Pittsburg Sunrise Rotary Foundation, Inc., Pittsburg, KS  
 Plymouth Education Foundation, Detroit, MI  
 Polish American Bobsleigh Federation, Inc., Shavertown, PA  
 Positive People, Inc., Chicago, IL  
 Psychiatric Resource Center, Inc., Palm Beach, FL  
 Puerto Rican Education Policy and Law Center, Harrisburg, PA  
 Purple Onion Production, Inc., Wallingford, CT  
 R. Clay Simmons Foundation for Community and Economic Development, Starkville, MS  
 Rainbow Wellness Center, Inc., Absecon, NJ  
 Redwood Area Quilters Association, New Ulm, MN  
 Reform Jewish Day School of Greater Philadelphia, Newton, PA  
 River Falls Community Arts Base, Inc., River Falls, WI  
 Rochelle Park Education Association Philanthropic Fund, Inc., Rochelle Park, NJ  
 Ronald N. Terrill Memorial Fund, Inc., Morrisville, VT  
 Rotary Club of Pike County Foundation, Waverly, OH  
 Rotary Club of Severna Park Foundation, Inc., Severna Park, MD  
 Round Table Services, Philadelphia, PA  
 Ruby Porter Family Counseling Center, Forest Park, IL  
 Rural Community Housing Assistance, Smithville, TN  
 Rural Housing Assistance, Alamo, TN  
 Saginaw High School Neighborhood Association, Saginaw, MI  
 San Antonio Mayors Committee for Employment of People with Disabilities, San Antonio, TX  
 San Marcos High School Alumni & Associates, Inc., Escondido, CA  
 Senior Citizens Home Safety Project, New Brunswick, NJ  
 Show Me Shooters, Inc., St. Louis, MO  
 Silveyville Parents Association, Dixon, CA  
 Singers Company, Akron, OH  
 Smith College Class of 1946, Stamford, CT  
 Sojourner Truth Center for Ethnic Diversity, Inc., Chicago, IL  
 Solutions VII, Inc., Washington, DC  
 South Jersey Museum of Art and Culture, Inc., Somerdale, NJ  
 South Suburban Community Council, Riverdale, IL  
 Springfield Volunteer Memorial Fund, Inc., Springfield, PA  
 St. Charles High School Hockey Club, Inc., St. Charles, MO  
 St. Francis Humane Society of Buffalo County, Inc., Mondovi, WI  
 St. Joseph County Minority Health Coalition, South Bend, IN  
 Staten Island Children's Campaign Charitable Tr, Staten Island, NY  
 Sudanese-American Community Development, Minneapolis, MN  
 Sunrise Residential, Inc., Tinley Park, IL  
 Susana Mi Amor Fund, Huntington, NY  
 Sussex County Knights Hockey Club, Inc., Newton, NJ  
 Swartmore Rotary Charitable Tr, Media, PA  
 Tehillah Ministries, Inc., Macon, GA  
 Ten Ten Foundation, Greenwich, CT  
 Tennessee Warbirds, Inc., Prescott, AZ  
 Texas Music International, Inc., Austin, TX  
 Three Rivers Academic Mentoring, Inc., Three Rivers, MI  
 Thursday Night Live, Pittsburgh, PA  
 Tops Rural Housing Programs, Newport, TN  
 Tot N Teen Foundation, Inc., Lake Forest, CA  
 Tru Development and Human Services, Inc., Jacksonville, FL  
 UMOJA Works, Washington, DC  
 Unified Human Services, Inc., Wall, NJ  
 Union County Schools Endowment Fund, Inc., New Albany, MS  
 United Congregation of Chester County, Coatesville, PA  
 Universal Improvement Association, Plainfield, NJ  
 Upper Bluff Society, Joliet, IL  
 U.S. Friends of Nightingale House, Inc., Great Neck, NY  
 Veddersburg, Inc., Amsterdam, NY  
 Verona Educational Foundation, Inc., Verona, NJ  
 Volunteer Institute for Creative Educational Science, Rockwood, TN  
 Washington Regional Network for Livable Communities, Washington, DC  
 Watch Hill Security Trust, Watch Hill, RI  
 Webster International Associates, Manchester, MO  
 West Amwell Township Education Foundation, Inc., Lambertville, NJ  
 West Deptford Field of Dreams, Inc., Thorofare, NJ  
 Wings for Wishes, Ltd., Greenfield, WI  
 Wings of Healing-Minnesota Incest Recovery Project, Minneapolis, MN  
 Wings of Mercy Mid-Michigan, Inc., Midland, MI  
 Wisconsin Foundation for School Music, Inc., Madison, WI  
 Woman Theatre, Inc., Philadelphia, PA  
 Women In Unity Foundation, Seattle, WA  
 Wonder World Enterprises, Blair, NE  
 Ypsilanti Band Association, Inc., Ypsilanti, MI

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

# Definition of Terms

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

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

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

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

*Modified* is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it

applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

*Superseded* describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the

new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case, the previously published ruling is first modified and then, as modified, is superseded.

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

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

## Abbreviations

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

A—Individual.  
Acq.—Acquiescence.  
B—Individual.  
BE—Beneficiary.  
BK—Bank.  
B.T.A.—Board of Tax Appeals.  
C—Individual.  
C.B.—Cumulative Bulletin.  
CFR—Code of Federal Regulations.  
CI—City.  
COOP—Cooperative.  
Ct.D.—Court Decision.  
CY—County.  
D—Decedent.  
DC—Dummy Corporation.  
DE—Donee.  
Del. Order—Delegation Order.  
DISC—Domestic International Sales Corporation.  
DR—Donor.  
E—Estate.  
EE—Employee.

E.O.—Executive Order.  
ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contributions Act.  
FISC—Foreign International Sales Company.  
FPH—Foreign Personal Holding Company.  
F.R.—Federal Register.  
FUTA—Federal Unemployment Tax Act.  
FX—Foreign Corporation.  
G.C.M.—Chief Counsel’s Memorandum.  
GE—Grantee.  
GP—General Partner.  
GR—Grantor.  
IC—Insurance Company.  
I.R.B.—Internal Revenue Bulletin.  
LE—Lessee.  
LP—Limited Partner.  
LR—Lessor.  
M—Minor.  
Nonacq.—Nonacquiescence.  
O—Organization.  
P—Parent Corporation.  
PHC—Personal Holding Company.

PO—Possession of the U.S.  
PR—Partner.  
PRS—Partnership.  
PTE—Prohibited Transaction Exemption.  
Pub. L.—Public Law.  
REIT—Real Estate Investment Trust.  
Rev. Proc.—Revenue Procedure.  
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Stat.—Statutes at Large.  
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T.C.—Tax Court.  
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T.I.R.—Technical Information Release.  
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TR—Trust.  
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U.S.C.—United States Code.  
X—Corporation.  
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### 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
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