

Internal Revenue bulletin

Bulletin No. 2003-15
April 14, 2003

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.

SPECIAL ANNOUNCEMENT

Announcement 2003-19, page 723.

This document contains the annual report to the public concerning Advance Pricing Agreements (APAs) and the experience of the APA Program during calendar year 2002. This document does not provide guidance regarding the application of the arm's length standard; rather, it reports on the structure and activities of the APA program.

INCOME TAX

Rev. Rul. 2003-37, page 717.

Capital expenditures; rotatable spare parts. This ruling informs taxpayers that the Service will follow *Hewlett Packard, Inc., v. United States*, 71 F.3d 398 (Fed. Cir. 1995), *rev'g Apollo Computer, Inc. and Subsidiaries v. United States*, 32 Fed. Cl. 334 (1994), and *Honeywell, Inc. and Subsidiaries v. Commissioner*, T.C. Memo 1992-453, *aff'd*, 27 F.3d 571 (8th Cir. 1994). Accordingly, taxpayers may treat rotatable spare parts as depreciable assets if the taxpayer's facts are substantially similar to *Hewlett Packard* and *Honeywell*.

EXEMPT ORGANIZATIONS

Announcement 2003-20, page 750.

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

ADMINISTRATIVE

Announcement 2003-17, page 722.

The Service announces that an updated edition of Publication 538, *Accounting Periods and Methods* (revised March 2003), is now available. This publication provides information on how to determine the appropriate accounting period and accounting method for your business.

Announcements of Disbarments and Suspensions begin on page 718.
Finding Lists begin on page ii.



Department of the Treasury
Internal Revenue Service

The IRS Mission

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

Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions and 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 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures.
(Also §§ 471; 1.471-1 and §§ 167; 167(a)-1.)

Capital expenditures; rotatable spare parts. This ruling informs taxpayers that the Service will follow *Hewlett Packard, Inc., v. United States*, 71 F.3d 398 (Fed. Cir. 1995), *rev'g Apollo Computer, Inc. and Subsidiaries v. United States*, 32 Fed. Cl. 334 (1994), and *Honeywell, Inc. and Subsidiaries v. Commissioner*, T.C. Memo 1992-453, *aff'd*, 27 F.3d 571 (8th Cir. 1994). Accordingly, taxpayers may treat rotatable spare parts as depreciable assets if the taxpayer's facts are substantially similar to *Hewlett Packard* and *Honeywell*.

Rev. Rul. 2003-37

The Internal Revenue Service will follow *Hewlett Packard, Inc. v. United States*, 71 F.3d 398 (Fed. Cir. 1995), *rev'g Apollo Computer, Inc. and Subsidiaries v. United States*, 32 Fed. Cl. 334 (1994), and *Honeywell, Inc. and Subsidiaries v. Commissioner*, T.C. Memo. 1992-453, *aff'd*, 27 F.3d 571 (8th Cir. 1994). Accordingly, taxpayers may treat rotatable spare parts as depreciable assets if the taxpayer's facts are substantially similar to *Hewlett Packard* and *Honeywell*.

In *Hewlett Packard*, the taxpayer manufactured and sold computers and related products, and provided maintenance and repair services under its product warranties and maintenance agreements. Most of the taxpayer's computer maintenance business was conducted pursuant to standardized maintenance agreements that obligated the taxpayer to provide all parts and labor, product upgrades, preventive maintenance, and telephone assistance necessary to keep a customer's computer operational for the duration of the contract (usually one year) in exchange for a predetermined fee.

In conducting its computer maintenance business, the taxpayer operated a separate repair facility and sent technicians to its customers' locations. The taxpayer maintained a pool of "rotatable spare parts" obtained

from its manufacturing facility. The taxpayer's repair technicians would use this supply of rotatable spare parts to diagnose problems in the customer's equipment. A customer's part that had been identified as the probable cause of the malfunction was replaced with the identical functioning part from the taxpayer's rotatable spare parts pool. The malfunctioning part removed from the customer's equipment would then be repaired and returned to the taxpayer's rotatable spare parts pool for continued use in the maintenance business. The taxpayer followed this practice of exchanging its rotatable spare parts for parts in a customer's computer to avoid rendering the computer inoperative while the original part was repaired.

On its federal income tax returns for the years at issue, the taxpayer treated its pool of rotatable spare parts as a capitalized fixed asset, which it depreciated and on which it took investment tax credits. The Service disallowed the depreciation deductions and investment tax credits on the ground that the taxpayer was required to characterize its pool of rotatable spare parts as property held primarily for sale in the ordinary course of business that should be included in inventory.

The Court of Federal Claims entered judgment in favor of the Service. The court concluded that a sale had occurred whenever the taxpayer exchanged one of its rotatable spare parts with a customer's part. However, the Court of Appeals for the Federal Circuit reversed, holding that the taxpayer's pool of rotatable spare parts was a capital asset used to provide services to customers under its computer maintenance contracts. The Appeals Court disagreed with both the characterization of the exchange of rotatable spare parts as a sale and the characterization of the parts as inventory.

Similarly, in *Honeywell*, the Tax Court held that a pool of rotatable spare parts was not held for sale and that the taxpayer was not required to treat the individual parts as inventory. The court stated that the pool of rotatable spare parts was necessary to the operation of the taxpayer's maintenance service business and was similar to an asset used in its trade or business within the meaning of § 167 of the Internal Revenue

Code to earn revenue from its maintenance agreements. The Court of Appeals for the Eighth Circuit affirmed the Tax Court's decision.

The Service has concluded, based on the above cases, that a taxpayer may treat rotatable spare parts as depreciable assets if the taxpayer's facts are substantially similar to those of the above cases. The Service intends to issue a revenue procedure under which qualifying taxpayers may apply to obtain automatic consent to change to a method of accounting consistent with *Hewlett Packard* and *Honeywell*. The Service intends to issue the revenue procedure in time for taxpayers to make the change for taxable years ending on or after December 31, 2002.

With respect to taxpayers who sell parts from their rotatable spare parts pools, the Service requests comments on the maximum amount of rotatable spare parts sales that should be permitted from a rotatable spare parts pool that is treated as a depreciable asset under the rationale of *Hewlett Packard* and *Honeywell* and how such amount should be measured (e.g., sales price of parts sold as a percentage of total revenues for the taxpayer's computer maintenance business). The Service also requests comments on any other issues that should be addressed in the revenue procedure. Comments should be submitted by May 23, 2003, either to:

Internal Revenue Service
P.O. Box 7604
Washington, DC 20044
Attn: CC:PA:RU (ITA:1)
Room 5553

or electronically at: Notice.Comments@irscounsel.treas.gov (the Service's comments e-mail address). All comments are available for public inspection and copying.

Drafting Information

The principal author of this revenue ruling is Gwen Turner of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Turner at (202) 622-5020 (not a toll-free call).

Part IV. Items of General Interest

Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Announcement 2003–15

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice be-

fore the Internal Revenue Service and may not knowingly aid or abet another person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility will announce

in the Internal Revenue Bulletin their names, their city and state, their professional designation, the effective date of disciplinary action, and the period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks.

Suspensions From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an opportunity for a proceeding before an

administrative law judge, the following individuals have been placed under suspen-

sion from practice before the Internal Revenue Service:

| Name | Address | Designation | Effective Date |
|----------------|-------------|-------------|--|
| Cramer, George | Chicago, IL | CPA | January 18, 2003 to January 17, 2005 |

Disbarments From Practice Before the Internal Revenue Service After Notice and an Opportunity for a Proceeding

Under Title 31, Code of Federal Regulations, Part 10, after notice and an oppor-

tunity for a proceeding before an administrative law judge, the following in-

dividuals have been disbarred from practice before the Internal Revenue Service:

| Name | Address | Designation | Effective Date |
|--------------------------|-----------------|----------------|-------------------|
| Whalley, Christopher J. | Ellsworth, ME | Attorney | July 28, 2002 |
| Chapin, Frank L. | Sandpoint, ID | Enrolled Agent | August 13, 2002 |
| Engstrand Jr., Edward E. | Minneapolis, MN | CPA | November 2, 2002 |
| Fisher, Joanna | Portland, OR | Enrolled Agent | November 15, 2002 |

Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled

actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice before

the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Profes-

sional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

| Name | Address | Designation | Date of Suspension |
|----------------------|--------------------|----------------|--|
| Kuhajda, Ben | Plainfield, IL | CPA | August 26, 2002 to August 24, 2005 |
| Vaughn, James A. | Albuquerque, NM | CPA | October 1, 2002 to September 29, 2004 |
| McBroom, Byron | Manteca, CA | CPA | October 21, 2002 to October 19, 2006 |
| Jacobs, Robert | Philadelphia, PA | Attorney | October 21, 2002 to April 20, 2006 |
| Kwak, Jong | Beverly Hills, CA | Attorney | October 22, 2002 to October 20, 2003 |
| Smith, Frank L. | Brooksville, FL | Attorney | November 1, 2002 to October 30, 2005 |
| Schwartz, Kenneth J. | Woodland Hills, CA | Attorney | November 1, 2002 to February 27, 2006 |
| Agulnick, Barry W. | New York, NY | Attorney | November 1, 2002 to April 29, 2004 |
| O'Connor, Thomas P. | Palos Park, IL | CPA | November 1, 2002 to October 20, 2003 |
| Brand, Joe A. | Dundee, OH | CPA | November 18, 2002 to November 16, 2004 |
| Battino, Steven | Plainview, NY | CPA | November 25, 2002 to May 23, 2004 |
| Chipman, Ken | Farmington, NM | Enrolled Agent | December 1, 2002 to November 29, 2003 |

| Name | Address | Designation | Date of Suspension |
|-------------------|------------------|-------------|--|
| Kirgis, Grant A. | Rochester, MN | CPA | December 1, 2002 to May 30, 2003 |
| Welch, Frank | Stamford, CT | CPA | Indefinite from January 31, 2003 |
| Pickens, Valerie | Seattle, WA | CPA | January 1, 2003 to December 30, 2004 |
| Kidd, Roger F. | Philadelphia, PA | Attorney | January 20, 2003 to April 18, 2003 |
| Sullivan, Raymond | Sonoma, CA | Attorney | March 15, 2003 to November 14, 2003 |

Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date

the expedited proceeding is instituted (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause or (2) has been convicted of certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

| Name | Address | Designation | Date of Suspension |
|-------------------|-----------------|-------------|---|
| Pirro, Anthony G. | South Salem, NY | CPA | Indefinite from June 26, 2002 |
| Scott, Roger | Buffalo, NY | Attorney | Indefinite from August 12, 2002 |
| Patrick, George | Cheshire, CT | CPA | Indefinite from September 9, 2002 |
| Rochon, Jason B. | Lafayette, LA | Attorney | Indefinite from September 9, 2002 |
| Voccola, Edward | Hingham, MA | Attorney | Indefinite from October 18, 2002 |

| Name | Address | Designation | Date of Suspension |
|-----------------------|-----------------------|-------------|---|
| Linn, Charles B. | Croton-on-Hudson, NY | Attorney | Indefinite from October 18, 2002 |
| Lum, Eugene K.H. | Long Beach, CA | Attorney | Indefinite from October 18, 2002 |
| Gwilliam, Peter | Lynn, MA | CPA | Indefinite from October 28, 2002 |
| Herlehy, Jon L. | McHenry, IL | CPA | Indefinite from October 28, 2002 |
| Herndon, Henry | Pikeville, NC | CPA | Indefinite from November 1, 2002 |
| McCurry, Todd | Durham, NC | Attorney | Indefinite from November 25, 2002 |
| Adams, James L. | Breckenridge, CO | Attorney | Indefinite from November 25, 2002 |
| Cloer, Stewart | Plano, TX | Attorney | Indefinite from December 13, 2002 |
| Caruso, Robert | Saddle River, NJ | CPA | Indefinite from December 16, 2002 |
| Duru, Ike E. | Atlanta, GA | Attorney | Indefinite from January 10, 2003 |
| Pelletier, Richard A. | Bolton, CT | CPA | Indefinite from January 10, 2003 |
| Austin, Jack | Steamboat Springs, CO | CPA | Indefinite from January 10, 2003 |
| Gibson, Brian M. | Monroe, NY | Attorney | Indefinite from January 10, 2003 |

| Name | Address | Designation | Date of Suspension |
|------------------|-----------------|-------------|--|
| Jackson, Robert | Mt. Juliet, TN | Attorney | Indefinite from January 10, 2003 |
| Tenzer, James L. | East Meadow, NY | Attorney | Indefinite from February 4, 2003 |

Resignations of Enrolled Agents

Under Title 31, Code of Federal Regulations, Part 10, an enrolled agent, in order to avoid the institution or conclusion of a proceeding for his or her disbarment or suspension from practice before the Inter-

nal Revenue Service, may offer his or her resignation as an enrolled agent. The Director, Office of Professional Responsibility, in his discretion, may accept the offered resignation.

The Director, Office of Professional Responsibility, has accepted offers of resignation as an enrolled agent from the following individuals:

| Name | Address | Date of Resignation |
|---------------|---------------|---------------------|
| Korman, Linda | Las Vegas, NV | January 23, 2003 |

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

Announcement 2003-17

Publication 538, revised March 2003, is now available from the Internal Revenue Service. It replaces the April 2001 revision.

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

You can get a copy of this publication by calling 1-800-TAX-FORM (1-800-829-3676) or by writing to the IRS Forms Distribution Center nearest you. Check your

income tax package for the address. The publication is also available on the IRS Internet web site at www.irs.gov.

Announcement and Report Concerning Advance Pricing Agreements

Announcement 2003–19

March 31, 2003

This Announcement is issued pursuant to § 521(b) of Pub. L. 106–170, the Ticket to Work and Work Incentives Improvement Act of 1999, requiring that the Secretary of the Treasury annually report to the public concerning Advance Pricing Agreements (APAs) and the APA Program. The first report covered calendar years 1991 through 1999. Subsequent reports covered calendar years 2000 and 2001. This fourth report describes the experience of the APA Program during calendar year 2002 consistent with the mandate of § 521(b). This document does not provide guidance regarding the application of the arm’s length standard; rather, it reports on the structure and activities of the APA program.

Mindy Piatoff
Acting Director, Advance Pricing Agreement Program

Background

Internal Revenue Code (IRC) § 482 provides that the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more commonly controlled businesses if necessary to reflect clearly the income of such businesses. Under the regulations, the standard to be applied in determining the true taxable income of a controlled business is that of a business dealing at arm’s length with an unrelated business. The arm’s length standard also has been adopted by the international community and is incorporated into the transfer pricing guidelines issued by the Organization for Economic Cooperation and Development (OECD). OECD, *TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATORS* (1995). Transfer pricing issues by their nature are highly factual and have traditionally been one of the largest issues identified by the IRS in its audits of multinational corporations. The APA Program is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional examination process. An APA is a binding contract between the IRS and a taxpayer by which the IRS agrees not to seek a transfer pricing adjustment under IRC § 482 for a covered transaction if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method (TPM). In year 2002, the IRS and taxpayers executed 85 APAs and amended 9 APAs.

Since 1991, with the issuance of Rev. Proc. 91–22, 1991–1 C.B. 526, the IRS has offered taxpayers through the APA Program the opportunity to reach an agreement in advance of filing a tax return on the appropriate TPM to be applied to related party transactions. In 1996, the IRS issued internal procedures for processing APA requests. Chief Counsel Directives Manual (CCDM), ¶¶ 42.10.10 – 42.10.16 (November 15, 1996). Also in 1996, the IRS updated Rev. Proc. 91–22 with the release of Rev. Proc. 96–53, 1996–2 C.B. 375. The APA Program continues to operate under the provisions of Rev. Proc. 96–53, which provides taxpayers with instructions of how to apply for an APA, and what to expect in the processing of the case. In addition, in 1998, the IRS published Notice 98–65, 1998–2 C.B. 803, which set forth streamlined APA procedures for Small Business Taxpayers (SBTs). That Notice also expanded the availability of the lowest APA user fee in an effort to attract taxpayers who may not have the resources to do the sophisticated economic studies normally required in APA submissions.

Advance Pricing Agreements

An APA generally combines an agreement between a taxpayer and the IRS on an appropriate TPM for the transactions at issue (Covered Transactions) with an agreement between the U.S. and one or more foreign tax authorities (under the authority of the mutual agreement process of our income tax treaties) that the TPM is correct. With such a “bilateral” APA, the taxpayer ordinarily is assured that the income associated with the Covered Transactions will not be subject to double taxation by the IRS and the foreign tax authority. It is the policy of the United States, as reflected in § 7 of Rev. Proc. 96–53 to encourage taxpayers that enter the APA program to seek bilateral or multilateral APAs when competent authority procedures are available with respect to the foreign country or countries involved. However, the IRS may execute an APA with a taxpayer without reaching a competent authority agreement (a “unilateral” APA).

A unilateral APA is an agreement between a taxpayer and the IRS establishing an approved TPM for U.S. tax purposes. A unilateral APA binds the taxpayer and the IRS, but obviously does not prevent foreign tax administrations from taking different positions on the appropriate TPM for a transaction. As stated in Rev. Proc. 96–53, should a transaction covered by a unilateral APA be subject to double taxation as the result of an adjustment by a foreign tax administration, the taxpayer may seek relief by requesting that the U.S. Competent Authority consider initiating a mutual agreement proceeding, provided there is an applicable income tax treaty in force with the other country.

When a unilateral APA involves taxpayers operating in a country that is a treaty partner, information relevant to the APA (including a copy of the APA and APA annual reports) may be provided to the treaty partner under normal rules and principles governing the exchange of information under income tax treaties.

The APA Program

APAs are negotiated with the taxpayer by an IRS team headed by an APA team leader. As of December 31, 2002, the APA program had 17 team leaders. The team leader is responsible for organizing the IRS APA team. The IRS APA team arranges meetings with the taxpayer, secures whatever information is necessary from the taxpayer to analyze the taxpayer's related party transactions and the available facts under the arm's length standard of IRC § 482 and the regulations thereunder (Treas. Reg.), and negotiates with the taxpayer.

The APA team generally includes an economist, an international examiner, LMSB field counsel, and, in a bilateral case, a U.S. Competent Authority analyst who leads the discussions with the treaty partner. The economist may be from the APA Program or the IRS field organization. As of December 31, 2002, the APA Program had 7 economists. The APA team may also include an LMSB International Technical Advisor, other LMSB exam personnel, and an Appeals officer.

The APA Process

The APA process is voluntary. Taxpayers submit an application for an APA, together with a user fee as set forth in Rev. Proc. 96-53. The APA process can be broken into five phases: (1) application; (2) due diligence; (3) analysis; (4) discussion and agreement; and (5) drafting, review, and execution.

(1) *Application*

In many APA cases, the taxpayer's application is preceded by a pre-file conference with the APA staff in which the taxpayer can solicit the informal views of the APA Program. Pre-file conferences can occur on an anonymous basis, although a taxpayer must disclose its identity when it applies for an APA. Taxpayers must file the appropriate user fee on or before the due date of the tax return for the first taxable year that the taxpayer proposes to be covered by the APA. Many taxpayers file a user fee first and then follow up with a full application later. The procedures for pre-file conferences, user fees, and delayed applications can be found in Rev. Proc. 96-53.

The APA application can be a relatively modest document for a small business taxpayer. Notice 98-65 describes the special APA procedures for small businesses. For most taxpayers, however, the APA application is a substantial document filling several binders. The APA Program makes every effort to reach agreement on the basis of the information provided in the taxpayer's application.

The application is assigned to an APA team leader who is responsible for the case. The APA team leader's first responsibility is to organize the APA team. This involves contacting the appropriate LMSB International Territory Manager to secure the assignment of an international examiner to the APA case and the LMSB Counsel's office to secure a field counsel lawyer. In a bilateral case, the U.S. Competent Authority will assign a U.S. Competent Authority analyst to the team. In a large APA case, the international examiner may invite his or her manager and other LMSB personnel familiar with the taxpayer to join the team. When the APA may affect taxable years in Appeals, the appropriate appellate conferee will be invited to join the team. In all cases, the team leader contacts the Manager, LMSB International Technical Advisors, to determine whether to include a technical advisor on the team. The IRS APA team will generally include a technical advisor if the APA request concerns cost-sharing, intangibles or services. The APA team leader then distributes copies of the APA application to all team members and sets up an opening conference with the taxpayer. The APA office strives to hold this opening conference within 45 days of the assignment of the case to a team leader. At the opening conference, the APA team leader proposes a case plan designed to complete the recommended U.S. negotiating position for a bilateral APA within 9 months from the date the full application was filed and to complete a unilateral APA within 12 months from the application date. In 2002, the median for completing negotiating positions was 12.0 months (average 13.7), and the median for completing unilateral APAs was 15.9 months (average 20.2).

(2) *Due Diligence*

The APA team must satisfy itself that the relevant facts submitted by the taxpayer are complete and accurate. This due diligence aspect of the APA is vital to the process. It is because of this due diligence that the IRS can reach advance agreements with taxpayers in the highly factual setting of transfer pricing. Due diligence can proceed in a number of ways. Typically, the taxpayer and the APA team will agree to dates for future meetings during the opening conference. In advance of the opening conference, the APA team leader will submit a list of questions to the taxpayer for discussion. The opening conference may result in a second set of questions. These questions are developed by the APA team and provided to the taxpayer through the APA team leader. It is important to note that this due diligence is not an audit and is focused on the transfer pricing issues associated with the transactions in the taxpayer's application, or such other transactions that the taxpayer and the IRS may agree to add.

(3) *Analysis*

A significant part of the analytical work associated with an APA is done typically by the APA or IRS field economist assigned to the case. The analysis may result in the need for additional information. Once the IRS APA team has completed its due diligence

and analysis, it begins negotiations with the taxpayer over the various aspects of the APA including the selection of comparable transactions, asset intensity and other adjustments, the TPM, which transactions to cover, the appropriate critical assumptions, the APA term, and other key issues. The APA team leader will discuss particularly difficult issues with his or her managers, but generally the APA team leader is empowered to negotiate the APA.

(4) *Discussion and Agreement*

This phase differs for bilateral and unilateral cases. In a bilateral case, the discussions proceed in two parts and involve two IRS offices — the APA Program and the U.S. Competent Authority. In the first part, the APA team will attempt to reach a consensus with the taxpayer regarding the recommended position that the U.S. Competent Authority should take in negotiations with its treaty partner. This recommended U.S. negotiating position is a paper drafted by the APA team leader and signed by the APA Director that provides the APA Program's view of the best TPM for the covered transaction, taking into account IRC § 482 and the regulations thereunder, the relevant tax treaty, and the U.S. Competent Authority's experience with the treaty partner.

The experience of the APA office and the U.S. Competent Authority is that APA negotiations are likely to proceed more rapidly with a foreign competent authority if the taxpayer fully supports the U.S. negotiating position. Consequently, the APA Office works together with the taxpayer in developing the recommended U.S. negotiating position. On occasion, the APA team will agree to disagree with a taxpayer. In these cases, the APA office will send a recommended U.S. negotiating position to the U.S. Competent Authority that includes elements with which the taxpayer does not agree. This disagreement is noted in the paper. The APA team leader also solicits the views of the field members of the APA team, and, in the vast majority of APA cases, the international examiner, LMSB field counsel, and other IRS field team members concur in the position prepared by the APA team leader.

Once the APA Program completes the recommended U.S. negotiating position, the APA process shifts from the APA Program to the U.S. Competent Authority. The U.S. Competent Authority analyst assigned to the APA takes the recommended U.S. negotiating position and prepares the final U.S. negotiating position, which is then transmitted to the foreign competent authority. The negotiations with the foreign competent authority are conducted by the U.S. Competent Authority analyst, most often in face-to-face negotiating sessions conducted periodically throughout the year. At the request of the U.S. Competent Authority analyst, the APA team leader may continue to assist the negotiations.

In unilateral APA cases, the discussions proceed solely between the APA Program and the taxpayer. In a unilateral case, the taxpayer and the APA Program must reach agreement to conclude an APA. Like the bilateral cases, the APA team leader almost always will achieve a consensus with the IRS field personnel assigned to the APA team regarding the final APA. The APA Program has a procedure in which the IRS field personnel are solicited formally for their concurrence in the final APA. This concurrence, or any items in disagreement, is noted in a cover memorandum prepared by the APA team leader that accompanies the final APA sent forward for review and execution.

(5) *Drafting, Review, and Execution*

Once the IRS and the taxpayer reach agreement, the drafting of the final APA generally takes little time because the APA Program has developed standard language that is incorporated into every APA. The current version of this language is found in Attachment A. APAs are reviewed by the Branch Chief and the APA Director. In addition, the team leader prepares a summary memorandum for the Associate Chief Counsel (International) (ACC(I)). On March 1, 2001, the ACC(I) delegated to the APA Director the authority to execute APAs on behalf of the IRS. See Chief Counsel Notice CC-2001-016. The APA is executed for the taxpayer by an appropriate corporate officer.

Model APA at Attachment A [§ 521(b)(2)(B)]

Attachment A contains the current version of the model APA language. As part of its continuing effort to improve its work product, the APA Program has revised the model language to reflect the program's collective experience with substantive and drafting issues.

The Current APA Office Structure, Composition, and Operation

In 2002, the APA Office consisted of four branches with Branches 1 and 3 staffed with APA team leaders and Branch 2 staffed with economists and a paralegal.¹ Branch 4, the APA West Coast branch, opened an additional office in Laguna Niguel and moved its headquarters there. Its staffing is indicated in the chart below.

¹ Branch 3 includes one team leader with the principal responsibility for annual report review and Branch 2 includes one economist who spends approximately 35% of his time reviewing annual reports.

Overall, the APA staff decreased from 38 to 34 as a result of attrition and transfers to other Chief Counsel functions. The number of APA team leaders decreased from 22 to 17, while the number of economists remained constant at 7. Despite the decrease in the number of APA team leaders, the combination of the APA Program's extensive training and smaller caseloads per APA team leader increased productivity and the currency of the APA inventory.

As of December 31, 2002, the APA staff was as follows:

| | | | |
|--|-----------------|-----------------|-----------------------------------|
| <i>Director's Office</i> | | | |
| 1 Acting Director (also Chief, Branch 1) | | | |
| 1 Special Counsel to the Director | | | |
| 1 Secretary to the Director | | | |
| <i>Branch 1</i> | <i>Branch 2</i> | <i>Branch 3</i> | <i>Branch 4</i> |
| 1 Branch Chief | 1 Branch Chief | 1 Branch Chief | 1 Branch Chief |
| 1 Secretary | 1 Paralegal | 1 Secretary | (Laguna Niguel) |
| 8 Team Leaders | 7 Economists | 7 Team Leaders | 1 Secretary (San Francisco) |
| | | | 2 Team Leaders (San Francisco) |

APA Training

In 2002, the APA Office continued to emphasize training as a high priority, dedicating two half-days each month to full staff training sessions. These training sessions regarded APA-related current developments, new APA office practices and procedures, and international tax law issues. Updated APA New Hire Training materials were published and provided to the APA staff, and to the public through the APA internet site on the IRS Digital Daily (www.irs.gov).

APA Program Statistical Data [§ 521(b)(2)(C) and (E)]

The statistical information required under § 521(b)(2)(C) is contained in Tables 1 and 9 below; the information required under § 521(b)(2)(E) is contained in Tables 2 and 3 below:

Table 1: APA Applications, Executed APAs, and Pending APAs

| | Unilateral | Bilateral | Multilateral | Year Total | Cumulative Total |
|--|-------------------|------------------|---------------------|-------------------|-------------------------|
| APA applications filed during year 2002 | 50 | 57 | | 107 | 676 |
| APAs executed | | | | | |
| • Year 2002 | 27 | 58 ² | | 85 | 434 |
| • 1991–2001 | 179 | 163 | 7 | 349 | |
| APA renewals executed during year 2002 | 9 | 12 | | 21 | 91 |
| Revised or Amended APAs executed during year 2002 ³ | 7 | 2 | | 9 | 21 |
| Pending requests for APAs | 48 | 155 | | 203 | |
| Pending requests for new APAs | 39 | 111 | | 150 | |
| Pending requests for renewal APAs | 9 | 44 | | 53 | |
| APAs canceled or revoked ⁴ | 0 | 0 | | 0 | 5 |
| APAs withdrawn ⁵ | 7 | 19 | | 26 | 80 |

² Approximately half of the 58 bilateral APAs executed in 2002 regarded companies carrying on limited business activities. These APAs were negotiated based on a bilateral competent authority agreement that established streamlined resolution guidelines.

³ In 2002, the APA Office and taxpayers agreed to amend nine APAs (seven unilateral and two bilateral). In six of these, the taxpayer reorganized its business. In three, the changes reflected technical corrections or modifications to minor aspects of the APA.

⁴ In the history of the APA Program, five APAs have been canceled and no APAs have been revoked.

⁵ Reasons for withdrawals included jurisdictional issues, inventory corrections, taxpayer reorganizations, and changes in facts and circumstances.

TABLE 2: MONTHS TO COMPLETE APAs

| Months to Complete Advance Pricing Agreements in Year 2002 | |
|--|------|
| Combined Unilateral, Bilateral, Multilateral: Average | 25.0 |
| Combined Unilateral, Bilateral, Multilateral: Median | 23.4 |

| Unilateral New | | Unilateral Renewal | | Unilateral Combined | |
|----------------|------|--------------------|------|---------------------|------|
| Average | 21.0 | Average | 19.1 | Average | 20.2 |
| Median | 15.9 | Median | 16.4 | Median | 15.9 |

| Bilateral/Multilateral New | | Bilateral/Multilateral Renewal | | Bilateral/Multilateral Combined ⁶ | |
|----------------------------|------|--------------------------------|------|--|------|
| Average | 24.6 | Average | 36.7 | Average | 27.3 |
| Median | 20.6 | Median | 34.4 | Median | 25.3 |

TABLE 3: APA COMPLETION TIME – MONTHS PER APA⁷

| Months | Number of APAs | Months | Number of APAs | Months | Number of APAs | Months | Number of APAs |
|--------|----------------|--------|----------------|--------|----------------|--------|----------------|
| 1 | 1 | 21 | 4 | 41 | 0 | 61 | 0 |
| 2 | 0 | 22 | 0 | 42 | 1 | 62 | 1 |
| 3 | 1 | 23 | 4 | 43 | 0 | 63 | 2 |
| 4 | 2 | 24 | 0 | 44 | 0 | 64 | 0 |
| 5 | 5 | 25 | 3 | 45 | 1 | 65 | 0 |
| 6 | 4 | 26 | 2 | 46 | 1 | 66 | 0 |
| 7 | 5 | 27 | 1 | 47 | 1 | 67 | 0 |
| 8 | 5 | 28 | 3 | 48 | 0 | 68 | 0 |
| 9 | 1 | 29 | 3 | 49 | 1 | 69 | 0 |
| 10 | 3 | 30 | 0 | 50 | 1 | 70 | 0 |
| 11 | 1 | 31 | 0 | 51 | 1 | 71 | 0 |
| 12 | 1 | 32 | 1 | 52 | 0 | 72 | 0 |
| 13 | 0 | 33 | 0 | 53 | 0 | 73 | 1 |
| 14 | 2 | 34 | 3 | 54 | 0 | 74 | 0 |
| 15 | 0 | 35 | 1 | 55 | 0 | 75 | 0 |
| 16 | 2 | 36 | 2 | 56 | 3 | 76 | 0 |
| 17 | 0 | 37 | 2 | 57 | 0 | 77 | 0 |
| 18 | 1 | 38 | 1 | 58 | 0 | 78 | 1 |
| 19 | 0 | 39 | 1 | 59 | 0 | 79 | 0 |
| 20 | 4 | 40 | 1 | 60 | 0 | 80 | 0 |

TABLE 4: RECOMMENDED NEGOTIATING POSITIONS

| | |
|--|----|
| Recommended Negotiating Positions Completed in Year 2002 | 85 |
|--|----|

⁶The average time required to conclude a bilateral APA has historically been split roughly equally between the APA and U.S. Competent Authority Offices.

⁷ Most of the APAs completed in six months or less related to companies carrying on limited business activities. These APAs were negotiated based on a bilateral competent authority agreement that established streamlined resolution guidelines.

TABLE 5: MONTHS TO COMPLETE RECOMMENDED NEGOTIATING POSITIONS

| New | | Renewal | | Combined | |
|---------|------|---------|------|----------|------|
| Average | 12.3 | Average | 18.2 | Average | 13.7 |
| Median | 11.5 | Median | 21.0 | Median | 12.0 |

TABLE 6: RECOMMENDED NEGOTIATING POSITIONS COMPLETION TIME – MONTHS PER APA⁸

| Months | Number | Months | Number | Months | Number | Months | Number |
|--------|--------|--------|--------|--------|--------|--------|--------|
| 1 | 0 | 11 | 2 | 21 | 4 | 31 | 1 |
| 2 | 2 | 12 | 7 | 22 | 2 | 32 | 0 |
| 3 | 2 | 13 | 4 | 23 | 2 | 33 | 0 |
| 4 | 1 | 14 | 4 | 24 | 5 | 34 | 0 |
| 5 | 13 | 15 | 2 | 25 | 1 | 35 | 0 |
| 6 | 3 | 16 | 0 | 26 | 0 | 36 | 0 |
| 7 | 3 | 17 | 0 | 27 | 1 | 37 | 1 |
| 8 | 4 | 18 | 6 | 28 | 2 | 38 | 0 |
| 9 | 5 | 19 | 4 | 29 | 0 | 39 | 0 |
| 10 | 2 | 20 | 1 | 30 | 1 | 40 | 0 |

TABLE 7: SMALL BUSINESS TAXPAYER APAs⁹

| | |
|--|----------|
| Small Business Taxpayer APAs Completed in Year 2002 | 6 |
| Renewals | 3 |
| New | 3 |
| Unilateral | 5 |
| Bilateral | 1 |

TABLE 8: MONTHS TO COMPLETE SMALL BUSINESS TAXPAYER APAs

| New | | Renewal | | Combined | |
|---------|------|---------|-----|----------|------|
| Average | 12.2 | Average | 8.1 | Average | 10.2 |
| Median | 8.4 | Median | 6.5 | Median | 7.7 |

⁸ A large number of the negotiating positions completed in six months or less related to companies carrying on limited business activities. These negotiating positions were associated with a bilateral competent authority agreement that established streamlined resolution guidelines.

⁹ Small Business Taxpayer APAs are processed under the special procedures set forth in Notice 98-65.

TABLE 9: INDUSTRIES COVERED

| Industry Involved – NAICS Codes¹⁰ | Number |
|---|---------------|
| Computer and electronic product manufacturing – 334 | 19–21 |
| Electronic equipment, appliance and component manufacturing – 335 | 16–18 |
| Miscellaneous manufacturing – 339 | 7–9 |
| Transportation equipment manufacturing – 336 | 7–9 |
| Apparel manufacturing – 315 | 4–6 |
| Wholesale trade, durable goods – 421 | 4–6 |
| Wholesale trade, nondurable goods – 422 | 4–6 |
| Machinery manufacturing – 333 | 1–3 |
| Clothing and clothing accessories stores – 448 | 1–3 |
| Motor vehicle and parts dealers – 441 | 1–3 |
| Air transportation – 481 | 1–3 |
| Mining (except oil and gas) – 211 | 1–3 |
| Food manufacturing – 311 | 1–3 |
| Beverage and tobacco manufacturing – 312 | 1–3 |
| Paper manufacturing – 322 | 1–3 |
| Chemical manufacturing – 325 | 1–3 |
| Nonmetallic mineral product manufacturing – 327 | 1–3 |
| Primary metal manufacturing – 331 | 1–3 |
| Food and beverage stores – 445 | 1–3 |
| Sporting goods, hobby, book and music stores – 451 | 1–3 |
| Broadcasting and telecommunications – 513 | 1–3 |
| Securities, commodity contracts and other intermediary and related activities – 523 | 1–3 |
| Publishing industries – 511 | 1–3 |

Trades or Businesses
[§ 521(b)(2)(D)(i)]

The nature of the relationships between the related organizations, trades, or businesses covered by APAs executed in Year 2002 is set forth in Table 10 below:

TABLE 10: NATURE OF RELATIONSHIPS BETWEEN RELATED ENTITIES

| Relationship | Number of APAs |
|---|-----------------------|
| Foreign Parent – U.S. Subsidiary (-ies) | 49 |
| U.S. Parent – Foreign Subsidiary (-ies) | 33 |
| Partnership | 2 |
| Other | 1 |

Covered Transactions
[§ 521(b)(2)(D)(ii)]

The controlled transactions covered by APAs executed in Year 2002 are set forth in Table 11 and Table 12 below:

¹⁰ The categories in this table are drawn from the North American Industry Classification System (NAICS), which has replaced the U.S. Standard Industrial Classification (SIC) system. NAICS was developed jointly by the U.S., Canada, and Mexico to provide new comparability in statistics about business activity across North America.

TABLE 11: TYPES OF COVERED TRANSACTIONS

| Transaction Type | Number |
|---|--------|
| Sale of tangible property into the US | 37 |
| Performance of services by Non-US entity | 35 |
| Performance of services by US entity | 26 |
| Sale of tangible property from the US | 18 |
| Use of intangible property by Non-US entity | 11 |
| Use of intangible property by US entity | 5 |
| Other | 6 |

TABLE 12: TYPES OF SERVICES INCLUDED IN COVERED TRANSACTIONS

| Intercompany Services Involved in the Covered Transactions | Number |
|--|--------|
| Manufacturing services ¹¹ | 30 |
| Distribution | 13 |
| Technical support services | 12 |
| Sales support | 10 |
| Logistical support | 9 |
| Administrative | 9 |
| Marketing | 9 |
| Product support | 8 |
| Management | 7 |
| Research and development | 6 |
| Accounting | 5 |
| Contract research & development | 4 |
| Testing and installation services | 4 |
| Warranty services | 4 |
| Headquarters costs | 4 |
| Assembly | 3 |
| Communication service | 3 |
| Legal | 3 |
| Repair | 3 |
| Billing services | 2 |
| Purchasing | 2 |

Business Functions Performed and Risks Assumed
[§ 521(b)(2)(D)(ii)]

The general descriptions of the business functions performed and risks assumed by the organizations, trades, or businesses whose results are tested in the covered transactions in the APAs executed in Year 2002 are set forth in Tables 13 and 14 below:

¹¹ Business activities addressed by a bilateral competent authority agreement that established streamlined guidelines for resolution.

TABLE 13: FUNCTIONS PERFORMED BY THE TESTED PARTY

| Functions performed | Number |
|--|---------------|
| Distribution functions | 55 |
| Product assembly and/or packaging | 52 |
| Marketing functions | 40 |
| Managerial, legal, accounting, finance, personnel, and other support services | 37 |
| Manufacturing | 35 |
| Product testing and quality control | 27 |
| Technical training and tech support for sales staff (including sub-distributors) | 26 |
| Purchasing and materials management | 24 |
| Transportation and warehousing | 23 |
| Research and development | 22 |
| Product service (repairs, etc.) | 21 |
| Product design and engineering | 18 |
| Licensing of intangibles | 13 |
| Process engineering | 10 |
| Consulting services | 10 |
| Customer service | 2 |
| Mining and extraction | 2 |

TABLE 14: RISKS ASSUMED BY THE TESTED PARTY

| Risks Assumed | Number |
|---|---------------|
| Market risks, including fluctuations in costs, demand, pricing, & inventory | 63 |
| General business risks (<i>e.g.</i> , related to ownership of PP&E) | 62 |
| Credit and collection risks | 45 |
| Financial risks, including interest rates & currency | 38 |
| Product liability risks | 19 |
| R&D risks | 18 |

Discussion

The vast majority of APAs have covered transactions that involve numerous business functions and risks. For instance, with respect to functions, companies that manufacture products have typically conducted research and development, engaged in product design and engineering, manufactured the product, marketed and distributed the product, and performed support functions such as legal, finance, and human resources services. Regarding risks, companies have been subject to market risks, R&D risks, financial risks, credit and collection risks, product liability risks, and general business risks. In the APA evaluation process a significant amount of time and effort is devoted to understanding how the functions and risks are allocated amongst the controlled group of companies that are party to the covered transactions.

In its APA submission, the taxpayer must provide a functional analysis. The functional analysis identifies the economic activities performed, the assets employed, the economic costs incurred, and the risks assumed by each of the controlled parties. The importance of the functional analysis derives from the fact that economic theory posits that there is a positive relationship between risk and expected return and that different functions provide different value and have different opportunity costs associated with them. It is important that the functional analysis go beyond simply categorizing the tested party as, say, a distributor. It should provide more specific information since, in the example of distributors, not all distributors undertake similar functions and risks.

Thus, the functional analysis is critical in determining the TPM (including the selection of comparables). Although functional comparability is an essential factor in evaluating the reliability of the TPM (including the selection of comparables), the APA evaluation process also involves consideration of economic conditions such as the economic condition of the particular industry.

In evaluating the functional analysis, the APA program considers contractual terms between the controlled parties and the consistency of the conduct of the parties with respect to the allocation of risk. In accord with the section 482 regulations, the APA program also gives consideration to the ability of controlled parties to fund losses that might be expected to occur as the result of the

assumption of risk. Another relevant factor considered in evaluating the functional analysis is the extent to which each controlled party exercises managerial or operational control over the business activities that directly influence the amount of income or loss realized. The section 482 regulations posit that parties at arm's length will ordinarily bear a greater share of those risks over which they have relatively more control.

**Related Organizations, Trades, or Businesses Whose Prices
or Results are Tested to Determine Compliance with APA Transfer Pricing Methods**
[§ 521(b)(2)(D)(iii)]

The related organizations, trades, or businesses whose prices or results are tested to determine compliance with TPMs prescribed in APAs executed in Year 2002 are set forth in Table 15 below:

**TABLE 15: RELATED ORGANIZATIONS, TRADES,
OR BUSINESSES WHOSE PRICES OR RESULTS ARE TESTED**

| Type of Organization | Number |
|--|--------|
| Non-US provider of services | 34 |
| Multiple tested parties ¹² | 30 |
| US distributor | 26 |
| US provider of services | 21 |
| US manufacturer | 11 |
| Non-US distributor | 5 |
| Non-US manufacturer | 2 |
| Non-US licensee of intangible property | 2 |
| Other | 7 |

Transfer Pricing Methods and the Circumstances Leading to the Use of Those Methods
[§ 521(b)(2)(D)(iv)]

The TPMs used in APAs executed in Year 2002 are set forth in Tables 16–20 below:

**TABLE 16: TRANSFER PRICING METHODS USED FOR
TRANSFERS OF TANGIBLE AND INTANGIBLE PROPERTY**

| TPM used | Number ¹³ |
|---|----------------------|
| Residual profit split | 14 |
| CPM: PLI is operating margin | 10 |
| CPM: PLI is Berry Ratio | 10 |
| CUT (intangibles only) | 8 |
| Resale Price Method (tangibles only) | 8 |
| CPM: PLI is markup on total costs | 6 |
| Unspecified method | 6 |
| CPM: PLI is Gross margin | 5 |
| Cost Plus Method (tangibles only) | 5 |
| CPM: PLI is other | 4 |
| CUP (tangibles only) – based on published market data | 3 |
| CUP (tangibles only) – not based on published market data | 2 |
| Other | 3 |

¹² “Multiple tested parties” includes covered transactions that utilize profit splits, CUPs, and CUTs.

¹³ Profit Level Indicators (“PLIs”) used with the Comparable Profit Method of Treas. Reg. § 1.482–5, and as used in these TPM tables, are as follows: (1) operating margin (ratio of operating profit to sales); (2) Berry ratio (gross profit to operating expenses); (3) markup on total costs (comparative markup on total costs); and (4) gross margin (ratio of gross profit to sales).

TABLE 17: TRANSFER PRICING METHODS USED FOR SERVICES

| TPM used | Number |
|-----------------------------------|--------|
| Cost plus a markup | 37 |
| Cost with no markup | 9 |
| CPM: PLI is markup on total costs | 7 |
| CPM: PLI is other | 4 |
| CPM: PLI is Berry Ratio | 2 |
| CPM: PLI is operating margin | 2 |
| Other | 5 |

Discussion

The TPMs used in APAs completed during Year 2002 were based on the section 482 regulations. Under Treas. Reg. § 1.482-3, the arm's length amount for controlled transfers of tangible property may be determined using the Comparable Uncontrolled Price (CUP) method, the Resale Price Method, the Cost Plus Method, the Comparable Profits Method (CPM), or the Profit Split method. Under Treas. Reg. § 1.482-4, the arm's length amount for controlled transfers of intangible property may be determined using the Comparable Uncontrolled Transaction (CUT) method, CPM, or the Profit Split Method. An "Unspecified Method" may be used for both tangible and intangible property if it provides a more reliable result than the enumerated methods under the best method rule of Treas. Reg. § 1.482-1(c). For transfers involving the provision of services, Treas. Reg. § 1.482-2(b) provides that services performed for the benefit of another member of a controlled group should bear an arm's length charge, either deemed to be equal to the cost of providing the services (when non-integral) or which should be an amount that would have been charged between independent parties.

In addition, Treas. Reg. § 1.482-2(a) provides rules concerning the proper treatment of loans or advances, and Treas. Reg. § 1.482-7 provides rules for qualified cost sharing arrangements under which the parties agree to share the costs of development of intangibles in proportion to their shares of reasonably anticipated benefits. APAs involving cost sharing arrangements generally address both the method of allocating costs among the parties as well as determining the appropriate amount of the "buy-in" payment due for the transfer of intangibles to the controlled participants.

In reviewing the TPMs applicable to transfers of tangible and intangible property reflected in Table 16, the majority of the APAs followed the specified methods. However, there are several distinguishing points that should be made. The Regulations note that for transfers of tangible property, the Comparable Uncontrolled Price (CUP) method will generally be the most direct and reliable measure of an arm's length price for the controlled transaction if sufficiently reliable comparable transactions can be identified. Treas. Reg. § 1.482-3(b)(2)(ii)(A). It was the experience of the APA Program in Year 2002 that in the cases that come into the APA Program, sufficiently reliable CUP transactions are difficult to find. In APAs executed in Year 2002, there were five covered transactions that used the CUP method; three looked to published market data and two used internal data on transactions between the taxpayer and unrelated parties.

Similar to the CUP method, for transfers of intangible property, the CUT method will generally provide the most reliable measure of an arm's length result if sufficiently reliable comparables may be found. Treas. Reg. § 1.482-4(c)(2)(ii). It has generally been difficult to identify external comparables, and APAs using the CUT method tend to rely on internal transactions between the taxpayer and unrelated parties. In Year 2002, there were eight covered transactions that utilized the CUT TPM.

The Cost Plus Method (tangibles only) and Resale Price Method were applied in Year 2002 in five and eight APAs respectively. See Treas. Reg. § 1.482-3(c), (d).

The CPM is frequently applied in APAs. This is because reliable public data on comparable business activities of independent companies may be more readily available than potential CUP data, and comparability of resources employed, functions, risks, and other relevant considerations is more likely to exist than comparability of product. The CPM also tends to be less sensitive than other methods to differences in accounting practices between the tested party and comparable companies, *e.g.*, classification of expenses as cost of goods sold or operating expenses. Treas. Reg. § 1.482-3(c)(3)(iii)(B), and -3(d)(3)(iii)(B). In addition, the degree of functional comparability required to obtain a reliable result under the CPM is generally less than required under the Resale Price or Cost Plus methods, because differences in functions performed often are reflected in operating expenses, and thus taxpayers performing different functions may have very different gross profit margins but earn similar levels of operating profit. Treas. Reg. § 1.482-5(c)(2).

Table 16 reflects 35 uses of the CPM (with varying PLIs) in covered transactions involving tangible or intangible property. The CPM was also used in some APAs concurrently with other methods.

The CPM has proven to be versatile in part because of the various PLIs that can be used in connection with the method. Reaching agreement on the appropriate PLI has been the subject of much discussion in many of the cases, and it depends heavily on the facts and circumstances. Some APAs have called for different PLIs to apply to different parts of the covered transactions or with one PLI used as a check against the primary PLI.

The CPM also was used regularly with services as the covered transactions in APAs executed in Year 2002. There were a total of fifteen services covered transactions using the CPM method with various PLIs according to the specific facts of the taxpayers involved. Table 17 reflects the methods used to determine the arm's length results for APAs involving services transactions.

In Year 2002, there were fourteen APAs involving tangible or intangible property that used the residual profit split, Treas. Reg. § 1.482-6(c)(3). In residual profit split cases, routine contributions by the controlled parties are allocated routine market returns, and the residual income is allocated among the controlled taxpayers based upon the relative value of their contributions of intangible property to the relevant business activity.

Critical Assumptions
[§ 521(b)(2)(D)(v)]

Critical Assumptions used in APAs executed in Year 2002 are described in Table 18 below:

TABLE 18: CRITICAL ASSUMPTIONS

| Critical Assumptions involving the following: | Number of APAs |
|---|-----------------------|
| Material changes to the business | 84 |
| Material changes to tax and/or financial accounting practices | 83 |
| Assets will remain substantially same | 31 |
| Consistency requirements, etc., for manufacturing services | 30 |
| Catastrophic events | 11 |
| Changes in affiliated companies | 5 |
| Major regulatory changes | 5 |
| Other financial ratio | 5 |
| Major contract remains in force | 5 |
| Material sales fluctuations | 4 |
| Marketing conditions substantially same | 3 |
| Currency fluctuations | 2 |
| Changes in other duties or tariffs | 2 |
| New import/export non-tariff barriers | 2 |
| Other | 7 |

Discussion

APAs include critical assumptions upon which their respective TPMs depend. A critical assumption is any fact (whether or not within the control of the taxpayer) related to the taxpayer, a third party, an industry, or business and economic conditions, the continued existence of which is material to the taxpayer's proposed TPM. Critical assumptions might include, for example, a particular mode of conducting business operations, a particular corporate or business structure, or a range of expected business volume. Rev. Proc. 96-53, § 5.07. Failure to meet a critical assumption may render an APA inappropriate or unworkable.

A critical assumption may change (and/or fail to materialize) due to uncontrollable changes in economic circumstances, such as a fundamental and dramatic change in the economic conditions of a particular industry. In addition, a critical assumption may change (and/or fail to materialize) due to a taxpayer's actions that are initiated for good faith business reasons, such as a change in business strategy, mode of conducting operations, or the cessation or transfer of a business segment or entity covered by the APA.

If a critical assumption has not been met, the APA may be revised by agreement of the parties. If such agreement cannot be achieved, the APA may be canceled. If a critical assumption has not been met, it requires taxpayer's notice to and discussion with the Service, and, in the case of a bilateral APA, competent authority consideration. Rev. Proc. 96-53, § 11.07.

**Sources of Comparables, Selection Criteria, and the Nature of Adjustments
to Comparables and Tested Parties**
[§ 521(b)(2)(D)(v), (vi), and (vii)]

The sources of comparables, selection criteria, and rationale used in determining the selection criteria for APAs executed in Year 2002 are described in Tables 19 through 21 below. Various formulas for making adjustments to comparables are included as Attachment B.

TABLE 19: SOURCES OF COMPARABLES

| Comparable Sources | Number of Times This Source Used |
|--------------------------------|-------------------------------------|
| Compustat | 81 |
| Disclosure | 50 |
| Moody's | 12 |
| Trade publication | 5 |
| Mergent | 2 |
| Bureau Van Dijk's JADE (Japan) | 2 |
| Other | 9 |

TABLE 20: COMPARABLE SELECTION CRITERIA

| Selection Criteria Considered | Number of Times This Criterion Used |
|-------------------------------|---|
| Comparable functions | 90 |
| Comparable risks | 65 |
| Comparable industry | 64 |
| Comparable products | 57 |
| Comparable intangibles | 27 |
| Comparable contractual terms | 4 |

TABLE 21: ADJUSTMENTS TO COMPARABLES OR TESTED PARTIES

| Adjustment | Number of Times This Adjustment Used |
|--|--|
| Balance sheet adjustments | — |
| Receivables | 40 |
| Inventory | 38 |
| Payables | 38 |
| Property, plant, equipment | 12 |
| Non-interest bearing liabilities | 2 |
| Other | 3 |
| Accounting adjustments | — |
| LIFO to FIFO inventory accounting ¹⁴ | 51 |
| Accounting reclassifications (e.g., from COGS to operating expenses) | 9 |
| Depreciation | 5 |
| Other | 2 |

¹⁴ The majority of these LIFO to FIFO inventory accounting adjustments regard business activities addressed by a bilateral competent authority agreement that established streamlined resolution guidelines.

TABLE 21: ADJUSTMENTS TO COMPARABLES OR TESTED PARTIES—Continued

| Adjustment | Number of Times This Adjustment Used |
|---|--|
| Profit level indicator adjustments (used to “back into” one PLI from another) | — |
| Operating expense | 2 |
| Other | 2 |
| Miscellaneous adjustments | — |
| Goodwill value or amortization | 23 |
| Foreign exchange | 10 |
| Other | 8 |

Discussion

At the core of most APAs are comparables. The APA program works closely with taxpayers to find the best and most reliable comparables for each covered transaction. In some cases, CUPs or CUTs can be identified. In other cases, comparable business activities of independent companies are utilized in applying the CPM or residual profit split methods. Generally, in the APA Program’s experience since 1991, CUPs and CUTs have been most often derived from the internal transactions of the taxpayer.

For profit-based methods in which comparable business activities or functions of independent companies are sought, the APA Program typically has applied a three-part process. First, a pool of potential comparables has been identified through broad searches. From this pool, companies having transactions that are clearly not comparable to those of the tested party have been eliminated through the use of quantitative and qualitative analyses, *i.e.*, quantitative screens and business descriptions. Then, based on a review of available descriptive and financial data, a set of comparable transactions or business activities of independent companies has been finalized. The comparability of the finalized set has then been enhanced through the application of adjustments.

Sources of Comparables

Comparables used in APAs can be U.S. or foreign. This depends on the relevant market, the type of transaction being evaluated, and the results of the functional and risk analyses. In general, comparables have been located by searching a variety of databases that provide data on U.S. publicly traded companies and on a combination of public and private non-U.S. companies. Table 19 shows the various databases and other sources used in selecting comparables for the APAs executed in Year 2002.

Although comparables were most often identified from the databases cited in Table 19, in some cases comparables were found from other sources, such as comparables derived internally from taxpayer transactions with third parties.

Selecting Comparables

Initial pools of potential comparables generally are derived from the databases using a combination of industry and keyword identifiers. Then, the pool is refined using a variety of selection criteria specific to the transaction or business activity being tested and the TPM being used.

The listed databases allow for searches by industrial classification, by keywords, or by both. These searches can yield a number of companies whose business activities may or may not be comparable to those of the entity being tested. Therefore, comparables based solely on industry classification or keyword searches are rarely used in APAs. Instead, the pool of comparables is examined closely, and companies are selected based on a combination of screens, business descriptions, and other information found in the companies’ Annual Reports to shareholders and filings with the U.S. Securities and Exchange Commission (SEC).

Business activities are required to meet certain basic comparability criteria to be considered comparables. Functions, risks, economic conditions, and the property (product or intangible) and services associated with the transaction must be comparable. Determining comparability can be difficult — the goal has been to use comparability criteria restrictive enough to eliminate business activities that are not comparable, but yet not so restrictive as to have no comparables remaining. The APA Program normally has begun with relatively strict comparability criteria and then has relaxed them slightly if necessary to derive a pool of reliable comparables. A determination on the appropriate size of the comparables set, as well as the business activities that comprise the set, is highly fact specific and depends on the reliability of the results.

In addition, the APA Program, consistent with the section 482 regulations, generally has looked at the results of comparables over a multi-year period. Sometimes this has been three years, but it has been more or less, depending on the circumstances of the controlled transaction. Using a shorter period might result in the inclusion of comparables in different stages of economic development or use of atypical years of a comparable subject to cyclical fluctuations in business conditions.

Many covered transactions have been tested with comparables that have been chosen using additional criteria and/or screens. These include sales level criteria and tests for financial distress and product comparability. These common selection criteria and screens have been used to increase the overall comparability of a group of companies and as a basis for further research. The sales level screen, for example, has been used to remove companies that, due to their size, might face fundamentally different economic conditions from those of the transaction or business activities being tested. In addition, APA analyses have incorporated selection criteria related to removing companies experiencing “financial distress” due to concerns that companies in financial distress often have experienced unusual circumstances that would render them not comparable to the business activity being tested. These criteria include: an unfavorable auditor’s opinion, bankruptcy, and in certain circumstances, operating losses in a given number of years.

An additional important class of selection criteria is the development and ownership of intangible property. In some cases in which the business activity being tested is a manufacturer, several criteria have been used to ensure, for example, that if the controlled entity does not own significant manufacturing intangibles or conduct research and development (R&D), then neither will the comparables. These selection criteria have included determining the importance of patents to a company or screening for R&D expenditures as a percentage of sales. Again, quantitative screens related to identifying comparables with significant intangible property generally have been used in conjunction with an understanding of the comparable derived from publicly available business information.

Selection criteria relating to asset comparability and operating expense comparability have also been used at times. A screen of property, plant, and equipment (PP&E) as a percentage of sales or assets, combined with a reading of a company’s SEC filings, has been used to help ensure that distributors (generally lower PP&E) were not compared with manufacturers (generally higher PP&E), regardless of their industry classification. Similarly, a test involving the ratio of operating expenses to sales has helped to determine whether a company undertakes a significant marketing and distribution function.

Table 22 shows the number of times various screens were used in APAs executed in Year 2002:

TABLE 22: COMPARABILITY SCREENS

| Comparability Screen Used | Number of Times Used |
|-----------------------------------|-----------------------------|
| Comparability screens used | — |
| Sales | 20 |
| R&D/ sales | 18 |
| Foreign sales/ total sales | 10 |
| SG&A/ sales | 10 |
| Non-startup or start-up | 4 |
| PP&E/ sales | 4 |
| PP&E/ total assets | 3 |
| Operating expenses/ sales | 2 |
| Financial distress | — |
| Losses in one or more years | 23 |
| Bankruptcy | 22 |
| Unfavorable auditor’s opinion | 12 |

Adjusting Comparables

After the comparables have been selected, the regulations require that “[i]f there are material differences between the controlled and uncontrolled transactions, adjustments must be made if the effect of such differences on prices or profits can be ascertained with sufficient accuracy to improve the reliability of the results.” Treas. Reg. § 1.482–1(d)(2). In almost all cases involving income-statement-based PLIs, certain “asset intensity” or “balance sheet” adjustments for factors that have generally agreed-upon effects on profits are calculated. In addition, in specific cases, additional adjustments are performed to improve reliability.

The most common balance sheet adjustments used in APAs are adjustments for differences in accounts receivable, inventories, and accounts payable. The APA Program generally has required adjustments for receivables, inventory, and payables based on the principle that there is an opportunity cost for holding assets. For these assets it is generally assumed that the cost is a short-term debt interest rate.

To compare the profits of two business activities with different relative levels of receivables, inventory, or payables, the APA Program estimates the carrying costs of each item and adjusts profits accordingly. Although different formulas have been used in specific APA cases, Attachment B presents one set of formulas used in many APAs. Underlying these formulas are the notions that (1) balance sheet items should be expressed as mid-year averages, (2) formulas should try to avoid using data items that are being tested by the TPM (for example, if sales are controlled, then the denominator of the balance sheet ratio should not be sales), (3) a short-term interest rate should be used, and (4) an interest factor should recognize the average holding period of the relevant asset.

The APA Program also requires that data be compared on a consistent accounting basis. For example, although financial statements may be prepared on a first-in first-out (FIFO) basis, cross-company comparisons are less meaningful if one or more of the comparables use LIFO inventory accounting methods. This adjustment directly affects costs of goods sold and inventories, and therefore affects both profitability measures and inventory adjustments.

Still important in some cases is the adjustment for differences in relative levels of PP&E between a tested business activity and the comparables. Ideally, comparables and the business activity being tested will have fairly similar relative levels of PP&E, since major differences can be a sign of fundamentally different functions and risks. Typically, the PP&E adjustment is made using a medium term interest rate.

Additional adjustments used less frequently include those for differences in other balance sheet items, operating expenses, R&D, or currency risk. Accounting adjustments, such as reclassifying items from cost of goods sold to operating expenses, for example, are also made when warranted to increase reliability. Often, data is not available for both the controlled and uncontrolled transactions in sufficient detail to allow for these types of adjustments.

The adjustments made to comparables or tested parties in APAs executed in Year 2002 are reflected in table 21 above.

Nature of Ranges and Adjustment Mechanisms
[§ 521(b)(2)(D)(viii)–(ix)]

The types of ranges and adjustment mechanisms used in APAs executed in Year 2002 are described in Table 23 and 24 below.

TABLE 23: TYPES OF RANGES

| Type of Range | Number ¹⁵ |
|--|----------------------|
| Interquartile range | 39 |
| Specific point within CPM range | 10 |
| Specific point (royalty) | 7 |
| Floor (<i>i.e.</i> , result must be no less than x) | 4 |
| Specific point (CUP) | 2 |
| Other | 10 |

TABLE 24: ADJUSTMENTS WHEN OUTSIDE OF THE RANGE

| Adjustment mechanism | Number |
|--|--------|
| Taxpayer makes an adjustment: to closest edge | 32 |
| Taxpayer makes an adjustment: to specified point | 20 |
| Taxpayer makes an adjustment: to median | 10 |
| Other | 5 |

Discussion

Treas. Reg. § 1.482–1(e)(1) states that sometimes a pricing method will yield “a single result that is the most reliable measure of an arm’s length result.” Sometimes, however, a method may yield “a range of reliable results,” called the “arm’s length range.” A taxpayer whose results fall within the arm’s length range will not be subject to adjustment.

Under Treas. Reg. § 1.482–1(e)(2)(i), such a range is normally derived by considering a set of more than one comparable uncontrolled transaction of similar comparability and reliability. If these comparables are of very high quality, as defined in the Regulations, then under Treas. Reg. § 1.482–1(e)(2)(iii)(A), the arm’s length range includes the results of all of the comparables (from the least to the greatest). However, the APA Program has only rarely identified cases meeting the requirements for the full range. If the

¹⁵ Numbers do not include TPMs with cost or cost-plus methodologies.

comparables are of lesser quality, then under Treas. Reg. § 1.482-1(e)(2)(iii)(B), “the reliability of the analysis must be increased, when it is possible to do so, by adjusting the range through application of a valid statistical method to the results of all of the uncontrolled comparables.” One such method, the “interquartile range,” is ordinarily acceptable, although a different statistical method “may be applied if it provides a more reliable measure.” The “interquartile range” is defined as, roughly, the range from the 25th to the 75th percentile of the comparables’ results. See Treas. Reg. § 1.482-1(e)(2)(iii)(C). The interquartile range was used 39 times in Year 2002.

Nineteen covered transactions reflected on Table 23 specified a single, specific result, or “point.” Ten of these covered transactions involved a CPM in which the taxpayer agreed to a specific result. Some APAs specify not a point or a range, instead using a “floor” that requires the tested party’s result be greater than or equal to some particular value. Four APAs executed in Year 2002 used a floor.

Some APAs look to a tested party’s results over a period of years (multi-year averaging) to determine whether a taxpayer has complied with the APA. In 2002, rolling multi-year averaging was used for twelve covered transactions. Eleven of those used three-year averages, and the other one used a five-year average. Cumulative multi-year averages were used for two covered transactions. Of those two transactions, one used a five-year average, and one used a seven-year average. Additionally, nine covered transactions used term averages.

Adjustments

Under Treas. Reg. § 1.482-1(e)(3), if a taxpayer’s results fall outside the arm’s length range, the Service may adjust the result “to any point within the arm’s length range.” Accordingly, an APA may permit or require a taxpayer and its related parties to make an adjustment after the year’s end to put the year’s results within the range, or at the point specified by the APA. Similarly, to enforce the terms of an APA, the Service may make such an adjustment. When the APA specifies a range, the adjustment is sometimes to the closest edge of the range, and sometimes to another point such as the median of the interquartile range. Depending on the facts of each case, such automatic adjustments are not always permitted. APAs may specify that in such a case there will be a negotiation between the competent authorities involved to determine whether and to what extent an adjustment should be made. APAs may permit automatic adjustments unless the result is far outside the range specified in the APA. Thus APAs provide flexibility and efficiency, permitting adjustments when normal business fluctuations and uncertainties push the result somewhat outside the range.

In order to conform the taxpayer’s books to these tax adjustments, the APA usually permits a “compensating adjustment” as long as certain requirements are met. Such compensating adjustments may be paid between the related parties with no interest, and the amount transferred will not be considered for purposes of penalties for failure to pay estimated tax. See § 11.02 Rev. Proc. 96-53.

APA Term Rollback Lengths
[§ 521(b)(2)(D)(x)]

The various term lengths for APAs executed in Year 2002 are set forth in Table 25 below:

TABLE 25: TERMS OF APAs

| APA Term in Years | Number of APAs |
|-------------------|----------------|
| 1 | 3 |
| 2 | 1 |
| 3 | 5 |
| 4 | 11 |
| 5 | 50 |
| 6 | 7 |
| 7 | 4 |
| 8 | 2 |
| 9 | 1 |
| 10 | 1 |

Number of rollback years to which an APA TPM was applied in Year 2002 is set forth in Table 26 below:

TABLE 26: NUMBER OF YEARS COVERED BY ROLLBACK OF APA TPM

| Number of Rollback Years | Number of APAs |
|--------------------------|----------------|
| 1 | 1 |
| 2 | 3 |
| 3 | 5 |
| 4 | 2 |
| 5 or more | 4 |

Nature of Documentation Required
[§ 521(b)(2)(D)(xi)]

APAs executed in Year 2002 required that taxpayers provide various documents with their annual reports. These documents are described in Table 27 below:

TABLE 27: NATURE OF DOCUMENTATION REQUIRED

| Documentation | Number of Times This Documentation Required ¹⁶ |
|---|---|
| Description of, reason for, and financial analysis of, any Compensating Adjustments with respect to APA Year, including means by which any Compensating Adjustment has been or will be satisfied | 85 |
| Statement identifying all material differences between Taxpayer's business operations during APA Year and description of Taxpayer's business operations contained in Taxpayer's request for APA, or if there have been no such material differences, a statement to that effect | 84 |
| Statement identifying all material changes in Taxpayer's accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer's request for APA, or if there have been none, statement to that effect | 84 |
| Financial analysis demonstrating Taxpayer's compliance with TPM | 84 |
| Description of any failure to meet Critical Assumptions or, if there have been none, a statement to that effect | 84 |
| Financial statements as prepared in accordance with US GAAP | 73 |
| Certified public accountant's opinion that financial statements present fairly financial position of Taxpayer and the results of its operations, in accordance with US GAAP | 73 |
| Organizational chart | 60 |
| Financial statements as prepared in accordance with a foreign GAAP | 30 |
| Various work papers | 30 |
| Certified public accountant's opinion that financial statements present fairly financial position of Taxpayer and the results of its operations, in accordance with a foreign GAAP | 24 |
| Book to tax reconciliations | 10 |
| Certified public accountant's review of financial statements | 4 |
| United States income tax return | 3 |
| Schedule of costs and expenses (e.g., intercompany allocations) | 3 |
| Other | 23 |

¹⁶ The first seven categories of documentation listed in this table were drawn from the standard APA language used in 2002. The facts and circumstances of some APAs may eliminate the need for some standard documentation requirements.

Approaches for Sharing of Currency or Other Risks
[§ 521(b)(2)(D)(xii)]

During Year 2002, there were 38 tested parties that faced financial risks, including interest rate and currency risks. Eleven APAs provide specific approaches for dealing with currency risk, including adjustment mechanisms and critical assumptions.

Efforts to Ensure Compliance with APAs
[§ 521(b)(2)(F)]

As described in Rev. Proc. 96-53, section 11, APA taxpayers are required to file annual reports to demonstrate compliance with the terms and conditions of the APA. The filing and review of annual reports is a critical part of the APA process. Through annual report review, the APA program monitors taxpayer compliance with the APA on a contemporaneous basis. Annual report review provides current information on the success or problems associated with the various TPMs adopted in the APA process.

All reports received by the APA Office are tracked by one designated APA team leader who also has the primary responsibility for annual report review. One of the economists also spends a significant amount of time reviewing annual reports. Other APA team leaders also assist in this review, especially when the team leader who negotiated the case is available, since that person will already be familiar with the relevant facts and terms of the agreement. Once received by the APA Office, the annual report is sent out to the district personnel with exam jurisdiction over the taxpayer.

The statistics for the review of APA annual reports are reflected in Table 28 below. As of December 31, 2002, there were 101 pending annual reports. In Year 2002, there were 330 reports closed.

TABLE 28: STATISTICS OF ANNUAL REPORTS

| | |
|--|-------------------|
| Number of APA annual reports pending as of December 31, 2002 | 101 |
| Number of APA annual reports closed in Year 2002 | 330 ¹⁷ |
| Number of APA annual reports requiring adjustment in Year 2002 | 5 |
| Number of taxpayers involved in adjustments | 2 |
| Number of APA annual reports required to be filed in Year 2002 | 199 |
| Number of APA annual reports actually filed in Year 2002 | 189 |
| Number of APA annual report cases over one year old | 37 |

¹⁷ This number differs from previously published figures because of annual reports closed but not yet entered on the system used to compile those statistics.

ATTACHMENT A
ADVANCE PRICING AGREEMENT
between
[Insert Taxpayer's Name]
and
THE INTERNAL REVENUE SERVICE

PARTIES

The Parties to this Advance Pricing Agreement (APA) are the Internal Revenue Service (IRS) and [Insert Taxpayer's Name], EIN _____ (Taxpayer).

RECITALS

Taxpayer's principal place of business is [City, State]. [Insert general description of taxpayer and other relevant parties.]

This APA contains the Parties' agreement on the best method for determining arm's-length prices of the Covered Transactions under I.R.C. section 482, any applicable tax treaties, and the Treasury Regulations.

Unless otherwise specified, terms in the plural include the singular and vice versa. Appendix D contains definitions for capitalized terms not elsewhere defined in this APA.

[If renewal add] [Taxpayer and IRS previously entered into an APA covering taxable years ending _____ to _____, executed on _____.]

AGREEMENT

The Parties agree as follows:

1. *Covered Transactions*. This APA applies to the Covered Transactions, as defined in Appendix A.
2. *Transfer Pricing Method*. Appendix A sets forth the Transfer Pricing Method (TPM) for the Covered Transactions.
3. *Term*. This APA applies to Taxpayer's taxable years ending _____ through _____ (APA Term).
4. *Operation*.
 - a. Revenue Procedure 96-53 governs the interpretation, legal effect, and administration of this APA.
 - b. Nonfactual oral and written representations, within the meaning of sections 10.04 and 10.05 of Revenue Procedure 96-53 (including any proposals to use particular TPMs), made in conjunction with this request constitute statements made in compromise negotiations within the meaning of Rule 408 of the Federal Rules of Evidence.
5. *Compliance*.
 - a. For each taxable year covered by this APA (APA Year), if Taxpayer complies with the terms and conditions of this APA, then the IRS will not make or propose any allocation or adjustment under I.R.C. section 482 to the Covered Transactions.
 - b. If Taxpayer does not comply, then the IRS may:
 - i. enforce the terms and conditions of this APA and make or propose allocations or adjustments under I.R.C. section 482 consistent with this APA;
 - ii. cancel or revoke this APA under section 11.05 or 11.06 of Revenue Procedure 96-53; or
 - iii. revise this APA, if the Parties agree.
 - c. Taxpayer must timely file an Annual Report for each APA Year in accordance with Appendix C and section 11.01 of Revenue Procedure 96-53. The IRS may request additional information reasonably necessary to clarify or complete the Annual Report. Taxpayer will provide all requested information within 30 days. Additional time may be allowed for good cause.
 - d. The IRS will determine whether Taxpayer has complied with this APA based on Taxpayer's U.S. Returns, Financial Statements, and other APA Records, for the APA Term and any other year necessary to verify compliance. For Taxpayer to comply with this APA, an independent certified public accountant must {use the following or an alternative} render an opinion that the Taxpayer's Financial Statements present fairly, in all material respects, Taxpayer's financial position under U.S. GAAP.
 - e. In accordance with section 11.04 of Revenue Procedure 96-53, Taxpayer will (1) maintain its APA Records, and (2) make them available to IRS in connection with an examination under section 11.03. Compliance with this subparagraph constitutes compliance with the record-maintenance provisions of I.R.C. sections 6038A and 6038C for the Covered Transactions for any taxable year during the APA Term.

f. If Taxpayer's actual transactions do not result in compliance with the TPM, Taxpayer:

- i. Must report its taxable income in an amount that is consistent with the TPM and all other requirements of this APA on its timely filed U.S. Return. However, for any APA Year, if Taxpayer's timely filed U.S. Return is filed no later than 60 days after the effective date of this APA, then Taxpayer may instead report its taxable income in an amount that is consistent with the TPM and all other requirements of this APA on an amended U.S. Return filed no later than 120 days after the effective date of this APA.
- ii. May make compensating adjustments under Revenue Procedure 96-53, section 11.02, subject to any modifications or restrictions in Appendix A or elsewhere in this APA.

g. *{Insert when U.S. Group or Foreign Group contains more than one member}*. [This APA addresses the arm's-length nature of prices charged or received in the aggregate between Taxpayer[s] and Foreign Participants. Except as explicitly provided, this APA does not address and does not bind the IRS with respect to prices charged or received, or the relative amounts of income or loss realized, by particular legal entities that are members of U.S. Group or that are members of Foreign Group.]

h. The True Taxable Income within the meaning of Treasury Regulations section 1.482-1(a)(1) of a member of an affiliated group filing a U.S. consolidated return will be determined under the I.R.C. section 1502 Treasury Regulations.

i. *{Optional for US Parent Signatories}* To the extent that Taxpayer's compliance with this APA depends on certain acts of Foreign Group members, Taxpayer will ensure that each Foreign Group member will perform such acts.

6. Critical Assumptions. This APA's critical assumptions, within the meaning of Revenue Procedure 96-53, section 5.07, appear in Appendix B. Revenue Procedure 96-53, section 11.07, governs if any critical assumption has not been met.

7. Disclosure. This APA, and any background information related to this APA or the APA Request, are: (1) considered "return information" under I.R.C. section 6103(b)(2)(C); and (2) not subject to public inspection as a "written determination" under I.R.C. section 6110(b)(1). Section 521(b) of Pub. L. 106-170 provides that the Secretary of the Treasury must prepare a report for public disclosure that includes certain specifically designated information concerning all APAs, including this APA, in a form that does not reveal taxpayers' identities, trade secrets, and proprietary or confidential business or financial information.

8. Disputes. If a dispute arises concerning the interpretation of this APA, the Parties will seek a resolution by the IRS Associate Chief Counsel (International), to the extent reasonably practicable, before seeking alternative remedies. If any dispute arises that is not related to interpreting this APA, the Parties will seek to resolve the dispute in a manner consistent with Revenue Procedure 96-53, section 11.03(4).

9. Materiality. In this APA the terms "material" and "materially" will be interpreted consistently with the definition of "material facts" in Revenue Procedure 96-53, section 11.05(1).

10. Section Captions. This APA's section captions, which appear in *italics*, are for convenience and reference only. The captions do not affect in any way the interpretation or application of this APA.

11. Entire Agreement and Severability. This APA is the complete statement of the Parties' agreement. The Parties will sever, delete, or reform any invalid or unenforceable provision in this APA to approximate the Parties' intent as nearly as possible.

12. Successor in Interest. This contract binds, and inures to the benefit of, any successor in interest to Taxpayer.

13. Notice. Any notices required by this APA or Revenue Procedure 96-53 must be in writing. Taxpayer will send notices to the IRS at the address and in the manner set forth in Revenue Procedure 96-53, section 5.13(2). The IRS will send notices to:

| |
|--|
| Taxpayer Corporation Attn: Jane Doe, Sr. Vice President (Taxes) 1000 Any Road Any City, USA 10000 (phone: _____) |
|--|

14. Effective date and Counterparts. This APA is effective starting on the date, or later date of the dates, upon which all Parties execute this APA. The Parties may execute this APA in counterparts, with each counterpart constituting an original.

WITNESS,

The Parties have executed this APA on the dates below.

[Taxpayer Name in all caps]

By: _____

Jane Doe

Sr. Vice President (Taxes)

Date: _____, 20 ____

IRS

By: _____

Mindy Piatoff

Acting Director, Advance Pricing Agreement Program

Date: _____, 20 ____

APPENDIX A

COVERED TRANSACTIONS AND TRANSFER PRICING METHOD (TPM)

1. Covered Transactions.

[Define the Covered Transactions.]

2. TPM.

[Note: If appropriate, adapt language from the following examples.]

• CUP Method

The TPM is the comparable uncontrolled price (CUP) method. The price charged for _____ must equal between _____ and _____ (the Arm's Length Range). Taxpayer must realize, recognize, and report results on its U.S. Returns that clearly reflect such pricing.

• Resale Price Method (RPM)

The TPM is the resale price method (RPM). Taxpayer must realize, recognize, and report results on its U.S. Returns that clearly reflect a gross margin (defined as gross profit divided by sales revenue as those terms are defined in Treasury Regulations sections 1.482-5(d)(1) and (2)) of between _____% and _____% (the Arm's Length Range) for the Covered Transactions.

• Cost Plus Method

The TPM is the cost plus method. Taxpayer must realize, recognize, and report results on its U.S. Returns that clearly reflect a ratio of gross profit to production costs (within the meaning of Treasury Regulations sections 1.482-3(d)(1) and (2)) of between _____% and _____% (the Arm's Length Range) for the Covered Transactions.

• CPM with Berry Ratio PLI

The TPM is the comparable profits method (CPM). Taxpayer must realize, recognize, and report results on its U.S. Returns that clearly reflect a gross profit to operating expenses ratio (as those terms are defined in Treasury Regulations sections 1.482-5(d)(2) and (3)) of between _____ and _____ (the Arm's Length Range) for the Covered Transactions.

• CPM using an Operating Margin PLI

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. Taxpayer's reported operating profit (within the meaning of Treasury Regulations sections 1.482-5(d)(5)) must clearly reflect an operating margin (defined as the ratio of operating profit to sales revenue as those terms are defined in Treasury Regulations section 1.482-5(d)(1) and (4)) of between _____% and _____% (the Arm's Length Range) for the Covered Transactions.

• CPM using a Three-year Rolling Average Operating Margin PLI

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. Taxpayer's Three-Year Rolling Average operating margin is defined as follows for any APA Year: the sum of Taxpayer's reported operating profit (within the meaning of Treasury Regulations section 1.482-5(d)(5)) for that APA Year and the two preceding years, divided by the sum of Taxpayer's sales revenue (within the meaning of Treasury Regulations section 1.482-5(d)(1)) for that APA Year and the two preceding years. Taxpayer's Three-Year Rolling Average operating margin must be between _____% and _____% (the Arm's Length Range).

• Residual Profit Split Method

The TPM is the residual profit split method. Taxpayer must realize, recognize, and report results on its U.S. Returns that clearly reflect the following: [insert description of profit-split mechanism].

[Insert additional provisions as needed.]

3. Adjustments

{For use with a CPM}

For each APA Year, if Taxpayer's year-end [Three-Year Rolling Average] {specify PLI used} for the Covered Transactions is not in compliance with the TPM, Taxpayer will make an adjustment that brings its [Three-Year Rolling Average] {specify PLI used} to {if the TPM specifies a point value, use that; if the TPM specifies an Arm's Length Range, use the nearest edge of the Arm's Length Range or a point such as the median within the Arm's Length Range}.

[Insert additional provisions as needed.]

APPENDIX B
CRITICAL ASSUMPTIONS

This APA's critical assumptions are:

1. The business activities, functions performed, risks assumed, assets employed, and financial and tax accounting methods and classifications [and methods of estimation] of Taxpayer in relation to the Covered Transactions will remain materially the same as described or used in Taxpayer's APA Request. A mere change in business results will not be a material change.

[Insert additional provisions as needed.]

APPENDIX C
APA RECORDS AND ANNUAL REPORT

APA RECORDS

The APA Records will consist of:

1. All documents listed below for inclusion in the Annual Report, as well as all documents, notes, work papers, records, or other writings that support the information provided in such documents.
2. *[Insert here other records as required.]*

ANNUAL REPORT

The Annual Report will include a cover sheet and a table of contents. The cover sheet will specify:

- i. the Parties to the APA
- ii. the APA Term (defined in section 3 of this APA)
- iii. the APA's effective date (defined in section 14 of this APA)
- iv. whether the APA is a renewal, and if so the term of the prior APA
- v. whether the APA has been amended, and if so the amendment's effective date
- vi. any information needed to distinguish the APA at issue from any other APAs involving the same parties
- vii. any changes to the Taxpayer notice information in section 13 of this APA

The table of contents and the Annual Report will be organized as listed below. Taxpayer must include the following items in its Annual Report for each APA Year.

1. Statements that fully identify, describe, analyze, and explain:

a. All material differences between any of Taxpayer's business operations (including functions, risks, markets, contractual terms, economic conditions, property or services, and assets employed) during the APA Year and the description of the business operations contained in the APA Request. If there have been no material differences, the Annual Report will include a statement to that effect.

b. All material changes in Taxpayer's accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer's request for this APA. If there have been no such material changes, the Annual Report will include a statement to that effect.

c. Any failure to meet any critical assumption. If there have been no failures, the Annual Report will include a statement to that effect.

d. Any change to any entity classification for federal income tax purposes (including any change that causes an entity to be disregarded for federal income tax purposes) of any Worldwide Group member that is a party to the Covered Transactions or is otherwise relevant to the TPM.

e. Any changes to Taxpayer's financial accounting methods that were made to conform to U.S. GAAP changes and that affect the Covered Transactions.

f. The amount, reason for, and financial analysis of any compensating adjustments under paragraph 5(f)(2) of this APA for the APA Year, including but not limited to:

- i. the amounts paid or received by each affected entity;

ii. the character (such as capital, ordinary, income, expense) and country source of the funds transferred, and the specific affected line item(s) of any affected U.S. Return; and

iii. the date(s) and means by which the payments are or will be made.

g. The amounts, description, reason for, and financial analysis of any book-tax differences relevant to the TPM for the APA Year, as reflected on Schedule M-1 of the U.S. Return for the APA Year.

2. The Financial Statements, and any necessary account detail to show compliance with the TPM, with a copy of each independent certified public accountant's opinion required by paragraph 5(d) of this APA.

3. A financial analysis that reflects Taxpayer's TPM calculations for the APA Year. The calculations must reconcile with and reference the Financial Statements in sufficient account detail to allow the IRS to determine whether Taxpayer has complied with the TPM.

4. An organizational chart for the Worldwide Group, revised annually to reflect all ownership or structural changes of entities that are parties to the Covered Transactions or are otherwise relevant to the TPM.

APPENDIX D
DEFINITIONS

The following definitions control for all purposes of this APA. The definitions appear alphabetically below:

| Term | Definition |
|-------------------------------|--|
| Annual Report | A report within the meaning of Revenue Procedure 96-53, section 11. |
| APA | This Advance Pricing Agreement, which is an “advance pricing agreement” within the meaning of Revenue Procedure 96-53, section 1. |
| APA Records | The records specified in Appendix C. |
| APA Request | Taxpayer’s request for this APA dated _____, including any amendments or supplemental or additional information thereto. |
| Covered Transaction | This term is defined in Appendix A. |
| Financial Statements | The financial statements prepared in accordance with U.S. GAAP and stated in U.S. dollars. |
| Foreign Group | Worldwide Group members that are not U.S. persons. |
| Foreign Participants | [name the foreign entities involved in Covered Transactions]. |
| I.R.C. | The Internal Revenue Code of 1986, 26 U.S.C., as amended. |
| Pub. L. 106-170 | The Ticket to Work and Work Incentives Improvement Act of 1999. |
| Revenue Procedure 96-53 | Rev. Proc. 96-53, 1996-2 C.B. 375. |
| Transfer Pricing Method (TPM) | A transfer pricing method within the meaning of Treasury Regulations section 1.482-1(b) and Revenue Procedure 96-53, section 3.02. |
| U.S. GAAP | U.S. generally-accepted accounting principles. |
| U.S. Group | Worldwide Group members that are U.S. persons. |
| U.S. Return | For each taxable year, the “returns with respect to income taxes under subtitle A” that Taxpayer must “make” in accordance with I.R.C. section 6012. { <i>Or substitute for partnership: For each taxable year, the “return” that Taxpayer must “make” in accordance with I.R.C. section 6031.</i> } |
| Worldwide Group | Taxpayer and all organizations, trades, businesses, entities, or branches (whether or not incorporated, organized in the United States, or affiliated) owned or controlled directly or indirectly by the same interests. |

ATTACHMENT B
FORMULAS FOR BALANCE SHEET ADJUSTMENTS

Definitions of Variables:

| | | |
|-------|---|--|
| AP | = | average accounts payable |
| AR | = | average trade accounts receivable, net of allowance for bad debt |
| cogs | = | cost of goods sold |
| INV | = | average inventory, stated on FIFO basis |
| opex | = | operating expenses (general, sales, administrative, and depreciation expenses) |
| PPE | = | property, plant, and equipment, net of accumulated depreciation |
| sales | = | net sales |
| tc | = | total cost (cogs + opex, as defined above) |
| h | = | average accounts payable or trade accounts receivable holding period, stated as a fraction of a year |
| i | = | interest rate |
| t | = | entity being tested |
| c | = | comparable |

Equations:

If Cost of Goods Sold is controlled (generally, sales in denominator of PLI):

| | |
|--------------------------------|---|
| Receivables Adjustment (“RA”): | $RA = \{[(AR_t / sales_t) \times sales_c] - AR_c\} \times \{i/[1+(i \times h_c)]\}$ |
| Payables Adjustment (“PA”): | $PA = \{[(AP_t / sales_t) \times sales_c] - AP_c\} \times \{i/[1+(i \times h_c)]\}$ |
| Inventory Adjustment (“IA”): | $IA = \{[(INV_t / sales_t) \times sales_c] - INV_c\} \times i$ |
| PP&E Adjustment (“PPEA”): | $PPEA = \{[(PPE_t / sales_t) \times sales_c] - PPE_c\} \times i$ |

If Sales are controlled (generally, costs in the denominator of PLI):¹⁸

| | |
|--------------------------------|---|
| Receivables Adjustment (“RA”): | $RA = \{[(AR_t / tc_t) \times tc_c] - AR_c\} \times \{i/[1+(i \times h_c)]\}$ |
| Payables Adjustment (“PA”): | $PA = \{[(AP_t / tc_t) \times tc_c] - AP_c\} \times \{i/[1+(i \times h_c)]\}$ |
| Inventory Adjustment (“IA”): | $IA = \{[(INV_t / tc_t) \times tc_c] - INV_c\} \times i$ |
| PP&E Adjustment (“PPEA”): | $PPEA = \{[(PPE_t / tc_t) \times tc_c] - PPE_c\} \times i$ |

Then Adjust Comparables as Follows:

| | | |
|-----------------------------|---|-----------------------------|
| adjusted sales _c | = | sales _c + RA |
| adjusted cogs _c | = | cogs _c + PA - IA |
| adjusted opex _c | = | opex _c - PPEA |

¹⁸ Depending on the specific facts, the equations below may use total costs (“tc”) or cost of goods sold (“cogs”).

Foundations Status of Certain Organizations

Announcement 2003–20

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:

- Aim for College Foundation, Inc., Hopedale, MA
American & Brazilian Association, Inc., Allston, MA
American Brotherhood for the Russian Disabled, Inc., Staten Island, NY
American Committee on Jerusalem, Washington, DC
American Friends of Beit Reuven, Inc., Brooklyn, NY
American Friends of Modzitz, Inc., Brooklyn, NY
American Friends of Ramat Eshkol, New York, NY
American Systems Educational Institute, San Francisco, CA
Angel City, Inc., Bozeman, MT
Angela L. Robins Better Living Foundation, San Diego, CA
Angels for Aliana Micheli Foundation, Aurora, IL
Answering Nurses Services Registry, Inc., Philadelphia, PA
Antioch/Carol City Community Development Corporation, Miami, FL
Applied Research Institute, Renton, WA
Aquatic Realm International Research and Preservation Society, Inc., Greenville, SC
ASA Productions, Inc., Hastings-On-Hudson, NY
Aspen Junior VBC, Inc., Aspen, CO
Association for Corporate Education, Inc., Dallas, TX
B. J. Johnsons Modern School of Self Defense, Inc., Jamaica, NY
Backroads Theater, Inc., New York, NY
Baitul Jannah Masjid & Community Center, Inc., Brooklyn, NY
Bangladesh Buddhist Society of America, Inc., Woodside, NY
Bay Area Foster Family Institute, Inc., El Sobrante, CA
Bayside Lions Services, Inc., Bacliff, TX
Bee Enterprise Educational Services, Inc., Pahoa, HI
Being Reunited With Opportunity, Inc., Baltimore, MD
Beis Medrash Toras Chayyim, New York, NY
Bellows Free Academy Endowment Fund, Inc., St. Albans, VT
Benton County Foundation for Better Education, Camden, TN
Berkshire Institute, Inc., Boston, MA
Bible Brethren Fellowship, Inc., Seffner, FL
Big Brothers Big Sisters of Nueces County, Corpus Christi, TX
Big Cat Foundation, Inc., Cincinnati, OH
Black & Gold Allsport Booster Club, Hesperia, CA
Black Dance Company, Rockford, IL
Blue River Elementary PTO, Stilwell, KS
Bradley Hospital Foundation Trusts, Providence, RI
Bridgeway Foundation, Inc., Fort Walton Beach, FL
Bright Light Community Services Dr. Herbert Bright, Plainfield, NJ
Britain Meets the Bay, San Francisco, CA
Broken Bread, Inc., Baltimore, MD
Browns Education and Recovery Center Bear, Houston, TX
Burbick Foundation, Cleveland, OH
Business Assistance Service, Inc., Glen Oaks, NY
California Space Grant Foundation, Redwood City, CA
Camp Ashreinu, Inc., Brooklyn, NY
Canosia Area Recreational Equipment Corp., Duluth, MN
Carry the Message, Inc., Glencoe, IL
Center for Research in Epidemiology and Endocrine Disorders, Inc., Shaker Heights, OH
Central Coast Youth Soccer League, Hollister, CA
Central Florida Partnership for Non Violence, Inc., Orlando, FL
Central Illinois Hockey League, Inc., Decatur, IL
Childrens Center of South Carolina, Columbia, SC
Childrens Connection, Lake Havasu City, AZ
Christian Generation Center of Hope, Inc., St. Petersburg, FL
Christian Help Service Ministries, Inc., Riverdale, GA
Christmas In April - Mobile, Mobile, AL
Christopher Radko Foundation for Children, Inc., Elmsford, NY
Citizens for Buckeye Basin Parks, Inc., Toledo, OH
Coalition of Concerned Individuals, Detroit, MI
Colegio De Estudios Tecnicos Profesionales Para La Salud, College Station, TX
Colorado Elementary Schools Network, Pueblo West, CO
Colorado Head Start Association, Colorado Springs, CO
Columbus Roadrunners, Columbus, OH
Committee for Preservation of Eretz Hakodesh, New York, NY
Community Enrichment & Legal Services, Inc., Van Nuys, CA
Community Foundation for Behavioral Health, Los Angeles, CA
Community Health Resource, Incorporated, Luthersville, GA
Community Services, Inc., Term, Fort Smith, AR
Community Video Media & Communication, Brooklyn, NY
Computer Literacy Project, Inc., Glendale, WI
Contemporary Annual, New York, NY
Coram Deo Ministries, Ketchum, ID
CRIME, Inc., Phoenix, AZ
Culture Corps, Inc., Boulder, CO
Defense Studies Foundation, Alexandria, LA
Delaware Multicultural and Civic Organization, Dover, DE
Derek Kennard Foundation, San Diego, CA
Diane M. Burbick Gifted Education Endowment, Cleveland, OH
Dignity, Inc., An Adolescent Female Learning Center, Denver, CO
District Institutes for Growth, Inc., Washington, DC

Dr. Paul Miller Foundation, Inc.,
 Denver, CO
 Dracut Police Association, Inc.,
 Dracut, MA
 Dreamstone, Inc., Ann Arbor, MI
 Eastern Massachusetts Assoc. of
 Interscholastic Football Office, Inc.,
 Brockton, NY
 Education Art & Music Corporation,
 Los Angeles, CA
 Education for Humanity USA, Inc.,
 Rochester, NY
 Edu-Kidz Foundation,
 Virginia Beach, VA
 Elgin Economic Action & Development
 Group, Elgin, IL
 Elijah Haven Crisis Intervention Center,
 Inc., LaGrange, IN
 Elkhorn Valley Dive Rescue, Inc.,
 Norfolk, NE
 Empower, Inc., Spartanburg, SC
 Environmental Awareness Control 2000,
 E. St. Louis, IL
 ETC Horse Rescue, Inc., Ocala, FL
 Eternal Life Ministries, Spring, TX
 Excitement Productions,
 Minneapolis, MN
 Faithful Deliverance Development, Inc.,
 Miami, FL
 Falls County Crime Stoppers, Inc.,
 Marlin, TX
 First Night Bridgewater-Raritan-
 Somerville, Inc., Somerville, NJ
 First Night Mt. Lebanon, Pittsburgh, PA
 For Christs Sake Television Ministry,
 Hayward, CA
 Fort Atkinson Wisconservation Club,
 Inc., Fort Atkinson, WI
 Fort Wayne Ice Skating Club, Inc.,
 Fort Wayne, IN
 Forums Institute for Public Policy,
 Princeton, NJ
 Foundation for Youth in
 Irondequoit, Rochester, NY
 Friends and Family of the Mentally
 Ill, Hemet, CA
 Friends of Albert C. Maule,
 Chicago, IL
 Friends of Esrat Cholim, Inc.,
 Brooklyn, NY
 Friends of Mizzos Haaretz, Inc.,
 Brooklyn, NY
 Friends of Oriskany Battlefield State
 Historic Site, Lake Geneva, WI
 Friends of the East Rockaway Grist Mill
 Museum, Inc., Lynbrook, NY
 Functional Water Society of North
 America, Alameda, CA
 Gemilas Chesed L Achanu M Russia,
 Inc., Brooklyn, NY
 Global Aide, Milwaukee, WI
 Global Purity Foundation,
 Monterey Park, CA
 God and Buddha Salvation Foundation,
 San Mimas, CA
 Grace Foundation for the Advancement
 of Disease Treatment,
 New York, NY
 Guadalupe Childrens
 Missions, Campbell, CA
 Gulf Coast Safe Dive Network, Inc.,
 Gulf Breeze, FL
 Haitian American Unified
 Council, Elizabeth, NJ
 Hands on Recovery Living
 Free, Chicago, IL
 Healthy Cronos Healthy Earth,
 Dallas, TX
 Helen Jaggar Scholarship Fund,
 Beloit, KS
 Helping Hand Food Giveaway
 Program, Denver, CO
 Hibernia Institute, Inc., Boise, ID
 His Little Ones, Inc., Wayne, NJ
 His Ministries, Inc., Cochran, PA
 Hispanic Coalition for Progress, Inc.,
 El Paso, TX
 Holy Family Resource Center,
 Linwood, MI
 Horses of Hope Riding Center,
 Baxter Springs, KS
 Houston Association of Parents of
 Visually Impaired, Houston, TX
 IA Foundation, Inc., Melville, NY
 ICE Christian Coalition, Inc.,
 Dallas, TX
 Impact Ministries, Inc.,
 Hermitage, TN
 In Home Advocacy Program, Inc.,
 Hyde Park, MA
 Inclusion Network, Mercer Island, WA
 Institute for Workplace Development,
 Inc., Mantua, NJ
 Instituto San Martiniano De Los Estados
 De America, Inc., New York, NY
 Integra, Inc., Montclair, NJ
 International Academy for Peace
 Education, Daly City, CA
 International Center for Jazz Foundation,
 Inc., New York, NY
 International Family Health and Safety
 Services, Lynnwood, WA
 Jacobs Ladder of Iowa, Inc.,
 Des Moines, IA
 Jean Houston Corporation,
 Crockett, TX
 Jefferson Music Heritage & Cultural
 Foundation, Inc., Metairie, LA
 Journey to the Rock Ministries,
 Chandler, AZ
 Joy and Happiness, Inc., Miami, FL
 Jungle Creations, Seattle, WA
 Justice Center of Oneida County,
 Inc., Utica, NY
 Juvenile Delinquency Alternative
 Prevention Program, Inc.,
 Houston, TX
 Kabir Foundation, Inc.,
 Sunnyvale, CA
 Kapiolani Marketing Association,
 Honolulu, HI
 Kent-Meridian Wrestling Booster Club,
 Kent, WA
 Keystone Oaks Hockey Club,
 Pittsburgh, PA
 Kindergarten Parents Club,
 Lynbrook, NY
 Kingdom Foundation, Inc., Atlanta, GA
 Know It Alls, Urbana, IL
 Koilel Bircas Shmuel, Inc.,
 Great Neck, NY
 La Belle Afrique Foundation,
 Omaha, NE
 Lago Vista Youth Basketball,
 Lago Vista, TX
 Lakeland Polk Housing Corporation,
 Lakeland, FL
 Larry Loves Kids Foundation,
 Inc., Stone Mountain, GA
 Las Vegas Performing Arts Center
 Foundation, Las Vegas, NV
 Last Chance Weed and Wildlife
 Association, Helena, MT
 Learn 4 Success, Inc.,
 Sacramento, CA
 Learning Center, Inc.,
 Cambria Heights, NY
 Leroy Wilson Memorial Scholarship
 Fund, S. Orange, NJ
 Lienzo Charro Aguilar, Inc.,
 Lufkin, TX
 Life Care Plus, Inc., San Pedro, CA
 Life of Victory Fellowship, Aurora, CO
 Lighthouse Charities, Inc., Bellwood, IL
 Lineville Development Corporation,
 Lineville, AL
 Long Island Conservatory Theatre, Inc.,
 Bayside, NY
 Love for Peace International,
 N. Miami, FL
 Lumen Gentium, Inc., Pittsburgh, PA
 Majlis Ash-Shura of New Jersey,
 Newark, NJ

Manetto Brook Masonic Historical Society, Hicksville, NY
 Maryce Foundation, Inc., Jamaica, NY
 Mazzei Foundation, Inc., Tulsa, OK
 McKinnley Leif Ericson Park Alliance, Ltd., Brooklyn, NY
 Meadows Home & Garden Club, Houston, TX
 Medical Missions International, Inc., Fort Lee, NJ
 Meeting Place of Pontiac, Inc., Pontiac, MI
 Megas Foundation, Rocky River, OH
 Melissa Semonin Memorial Scholarship Fund, Atwater, OH
 Methodist Orphanage Methodist Home for Children Alumni Association, Clayton, NC
 Metro Asian Cultural Exchange, Inc., Flushing, NY
 Miami Hemispheric Cultural Exposition, Inc., Miami, FL
 Ministerio El Faro Palm Bay, Inc., the Lighthouse Ministries Palm Bay, Inc., Melbourne, FL
 Mokelumne Manor Thornton Homes, Thornton, CA
 Montgomery FFA Booster Club, Montgomery, TX
 Morgan Hill Gymnastics Booster Club, Morgan Hill, CA
 Mt. Arab Masonic Historical Society, Tuper Lake, NY
 Museum of Northern California, Chico, CA
 Mustang Wetlands Conservancy, Dallas, TX
 Nat Turner Historical Society, Inc., Waverly, VA
 National Credit Counselors, Inc., Elmont, NY
 National Telephone Prayer Circle Society, Gainesville, FL
 Native American Promotions, Inc., Bartlett, IL
 New Braunfels Junior Golf Association, New Braunfels, TX
 New Millennium Development Services, Inc., Roosevelt, NY
 New Vision Outreach Ministries, Inc., Valdosta, GA
 NHS Singers Parent Associates, Inc., Noblesville, IN
 Nichibei Potomac Society, Alexandria, VA
 Nigeria Meningitis Appeal Fund NMAF, Inc., Boston, MA
 North Baldwin Sheriffs Search & Rescue, Inc., Bay Minette, AL
 North Carolina Assisted Living Foundation, Cary, NC
 Oak Ridge High School Band Booster Association, Conroe, TX
 Oneal Parent Teacher Organization, Poplar Bluff, MO
 Opelousas Main Street Program, Inc., Opelousas, LA
 Operation Hands On, Inc., OHO, Kihei, HI
 Ophthalmology Education Worldwide, Cleveland, OH
 Opp Historical Society, Inc., Opp, AL
 Oradell Arts & Business Coalition, Inc., Oradell, NJ
 Orange County Players, Inc., Paoli, IN
 Orville L. Rodberg Charitable Foundation, Inc., West Palm Beach, FL
 Overcomers in Christ Family Restoration Ministries, Inc., Richmond, VA
 Paramount Baseball Traveling Team, Paramount, CA
 Parenting Institute, Portland, OR
 Paso Robles Multi Flora Garden Club, Paso Robles, CA
 Patrick D. Hubbard Ministries, Pearl River, LA
 Patrol Land Foundation, Delmar, NY
 Platforms, Inc., New York, NY
 Plymouth South High School Hockey Booster, Inc., Plymouth, MA
 Portland Area Soccer Association, Portland, MI
 Potomac Swamp Society, Washington, DC
 Prairie Wildlife Rehabilitation, Inc., Warrensburg, IL
 Praying Teachers Network, Cookeville, TN
 Preventing Tobacco Addiction, Dublin, OH
 Prevle County Youth Foundation, Inc., Eaton, OH
 Prince Hall Temple Associates, Inc., New York, NY
 Prince Henry Sinclair Society of the United States, Inc., Orangeburg, NY
 Professional Business Institute, Inc., Brooklyn, NY
 Progress Village Panthers, Inc., Riverview, FL
 Project Phoenix, Henderson, NV
 Project Reality, Inc., Brockton, MA
 Public Safety and Education Department, Markham, IL
 Queensbury Masonic Historical Society, Queensbury, NY
 Quincy Development Association, Quincy, IL
 Racing for Abused Children's Needs Foundation, Costa Mesa, CA
 Rare Disease Awareness Center, San Diego, CA
 Reach International, Inc., Dallas, TX
 Recoveryworks, Inc., Oxnard, CA
 Renewal A Spiritual Journey, Austin, TX
 Resurrection Ministries, Inc., Texarkana, TX
 Rhodius Booster Club, Indianapolis, IN
 Richmond Citizens Police Academy Alumni Association, Richmond, TX
 Riverrun Center, Inc., New London, CT
 Rochambeau Foundation, Inc., Middlebury, CT
 Rock Springs Community Chest, Rock Springs, WY
 Rockaway Fighting Irish Football Club, Inc., Rockaway, NY
 Safety Net BBS, Inc., Marietta, GA
 Saint Maria Goretti Guild, Inc., Ocala, FL
 Sandwich Youth Tackle Football, Sandwich, IL
 Scholars Phair Foundation, Inc., Denton, TX
 Search and Rescue of the Northern Adirondacks, Inc., Saranac Lake, NY
 Seays Evangelistic Outreach Center, Inc., Davenport, FL
 Segment Educational Support Corporation, Malibu, CA
 Self Esteem Foundation, Inc., Huntington, NY
 Shaaman, Denver, CO
 Sherit Isroel, Inc., Brooklyn, NY
 South County Youth Productions Corp., Chandler, AZ
 Southern Sudanese Community of Austin, Austin, TX
 Southern Wayne Co. Association for the Education of Young Children, Lincoln Park, MI
 Southwest Musical Arts Foundation, Scottsdale, AZ
 Spiritual Awakening USA, Bolivar, MO
 St. James Lutheran School Foundation, Chicago, IL
 St. Petersburg Economic Opportunities Unlimited, Inc., St. Petersburg, FL
 Stand By Me, Inc., Waterbury, CT

Still Waters Retreat Center, Inc.,
Cypress, TX
Stuart Grant's Academy Rewards,
Ferndale, MI
Sussex County Hockey Association,
Hamburg, NJ
Team One For Kids, Plainfield, IL
Technical Resources for Environmental
Quality, Inc., Milton, MA
Texas Ices, Arlington, TX
Theatre World Awards, Inc.,
Metuchen, NJ
Third Place, Inc., Sarasota, FL
Tonga USA Today, Honolulu, HI
Tourette Syndrome Permanent Research
Fund, Inc., Bayside, NY
True Vine Community Services
Organizations, Inc.,
Minneapolis, MN
Ulster County Daycare and Nursery
School Scholarship Fund,
Shokan, NY
Union City Area Pee Wee Football
Boosters, Inc., Union City, IN
Universal Gymnastics Booster Club,
Inc., Miami, FL
Up Stage Productions, Inc.,
Ft. Collins, CO
Up to Youth, Inc., Littleton, MA

Urban Health Foundation, Inc.,
Bronx, NY
Utah Recreation and Parks Association,
Inc., Salt Lake City, UT
Venice H. E. A. R. T., Topanga, CA
Veteran Environmental Trailblazers,
Inc., Pittsburgh, PA
Virginia Alliance of Quilters Museum,
Hopewell, VA
Walker County Youth Football, Assoc.,
Huntsville, TX
Walker's Elderly Home Care, Inc.,
New Orleans, LA
Water of Life Community Outreach,
Inc., Rancho Cucamonga, CA
WE Band Boosters, Inc.,
Bowling Green, KY
Wemi Sohalawak, Inc., Longpond, PA
West Suburban Association of the Deaf,
Oak Brook, IL
Westfield High School Ice Hockey
Association, Westfield, NJ
Whatcom County Association of Foster
and Adoptive Families,
Bellingham, WA
William Stout Institute for Measurement,
Champaign, IL
Willing Heart Publications, Inc.,
Modesto, CA

Winter Garden Services, Inc.,
Carrizo Springs, TX
WIT Services, Rockford, IL
Wolverine Football Club, Irvine, CA
Womens Civic League, Poplarville, MS
Work Fair Construction, Inc.,
Miller Place, NY
World Healthcare Foundation,
Cincinnati, OH
World View, Inc., Roswell, GA
Yellow Bike Program & Reconditioned
Bikes for Kids, Rapid City, SD
Yeshiva Beit Rafael, Flushing, NY
Zia Deaf Blind Club of New Mexico,
Inc., Albuquerque, NM

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.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List¹

Bulletins 2003-1 through 2003-14

Announcements:

2003-1, 2003-2 I.R.B. 281
2003-2, 2003-3 I.R.B. 301
2003-3, 2003-4 I.R.B. 361
2003-4, 2003-5 I.R.B. 396
2003-5, 2003-5 I.R.B. 397
2003-6, 2003-6 I.R.B. 450
2003-7, 2003-6 I.R.B. 450
2003-8, 2003-6 I.R.B. 451
2003-9, 2003-7 I.R.B. 490
2003-10, 2003-7 I.R.B. 490
2003-11, 2003-10 I.R.B. 585
2003-12, 2003-10 I.R.B. 585
2003-13, 2003-11 I.R.B. 603
2003-14, 2003-11 I.R.B. 603
2003-15, 2003-11 I.R.B. 605
2003-16, 2003-12 I.R.B. 641
2003-18, 2003-13 I.R.B. 675

Notices:

2003-1, 2003-2 I.R.B. 257
2003-2, 2003-2 I.R.B. 257
2003-3, 2003-2 I.R.B. 258
2003-4, 2003-3 I.R.B. 294
2003-5, 2003-3 I.R.B. 294
2003-6, 2003-3 I.R.B. 298
2003-7, 2003-4 I.R.B. 310
2003-8, 2003-4 I.R.B. 310
2003-9, 2003-5 I.R.B. 369
2003-10, 2003-5 I.R.B. 369
2003-11, 2003-6 I.R.B. 422
2003-12, 2003-6 I.R.B. 422
2003-13, 2003-8 I.R.B. 513
2003-14, 2003-8 I.R.B. 515
2003-15, 2003-9 I.R.B. 540
2003-16, 2003-10 I.R.B. 575
2003-17, 2003-12 I.R.B. 633
2003-18, 2003-14 I.R.B. 699
2003-19, 2003-14 I.R.B. 703

Proposed Regulations:

REG-209500-86, 2003-2 I.R.B. 262
REG-104385-01, 2003-12 I.R.B. 634
REG-116641-01, 2003-8 I.R.B. 518
REG-125638-01, 2003-5 I.R.B. 373
REG-126016-01, 2003-7 I.R.B. 486
REG-126485-01, 2003-9 I.R.B. 542
REG-103580-02, 2003-9 I.R.B. 543
REG-124069-02, 2003-7 I.R.B. 488
REG-131478-02, 2003-13 I.R.B. 669
REG-138882-02, 2003-8 I.R.B. 522
REG-139768-02, 2003-10 I.R.B. 583
REG-151043-02, 2003-3 I.R.B. 300
REG-164464-02, 2003-2 I.R.B. 262

Revenue Procedures:

2003-1, 2003-1 I.R.B. 1
2003-2, 2003-1 I.R.B. 76
2003-3, 2003-1 I.R.B. 113
2003-4, 2003-1 I.R.B. 123

Revenue Procedures—Continued:

2003-5, 2003-1 I.R.B. 163
2003-6, 2003-1 I.R.B. 191
2003-7, 2003-1 I.R.B. 233
2003-8, 2003-1 I.R.B. 236
2003-9, 2003-8 I.R.B. 516
2003-10, 2003-2 I.R.B. 259
2003-11, 2003-4 I.R.B. 311
2003-12, 2003-4 I.R.B. 316
2003-13, 2003-4 I.R.B. 317
2003-14, 2003-4 I.R.B. 319
2003-15, 2003-4 I.R.B. 321
2003-16, 2003-4 I.R.B. 359
2003-17, 2003-6 I.R.B. 427
2003-18, 2003-6 I.R.B. 439
2003-19, 2003-5 I.R.B. 371
2003-20, 2003-6 I.R.B. 445
2003-21, 2003-6 I.R.B. 448
2003-22, 2003-10 I.R.B. 577
2003-23, 2003-11 I.R.B. 599
2003-24, 2003-11 I.R.B. 599
2003-25, 2003-11 I.R.B. 601
2003-26, 2003-13 I.R.B. 666
2003-27, 2003-13 I.R.B. 667

Revenue Rulings:

2003-1, 2003-3 I.R.B. 291
2003-2, 2003-2 I.R.B. 251
2003-3, 2003-2 I.R.B. 252
2003-4, 2003-2 I.R.B. 253
2003-5, 2003-2 I.R.B. 254
2003-6, 2003-3 I.R.B. 286
2003-7, 2003-5 I.R.B. 363
2003-8, 2003-3 I.R.B. 290
2003-9, 2003-4 I.R.B. 303
2003-10, 2003-3 I.R.B. 288
2003-11, 2003-3 I.R.B. 285
2003-12, 2003-3 I.R.B. 283
2003-13, 2003-4 I.R.B. 305
2003-14, 2003-4 I.R.B. 302
2003-15, 2003-4 I.R.B. 302
2003-16, 2003-6 I.R.B. 401
2003-17, 2003-6 I.R.B. 400
2003-18, 2003-7 I.R.B. 467
2003-19, 2003-7 I.R.B. 468
2003-20, 2003-7 I.R.B. 465
2003-21, 2003-8 I.R.B. 509
2003-22, 2003-8 I.R.B. 494
2003-23, 2003-8 I.R.B. 511
2003-24, 2003-10 I.R.B. 557
2003-25, 2003-13 I.R.B. 642
2003-26, 2003-10 I.R.B. 563
2003-27, 2003-11 I.R.B. 597
2003-28, 2003-11 I.R.B. 594
2003-29, 2003-11 I.R.B. 587
2003-30, 2003-13 I.R.B. 659
2003-31, 2003-13 I.R.B. 643
2003-32, 2003-14 I.R.B. 689
2003-33, 2003-13 I.R.B. 642
2003-35, 2003-14 I.R.B. 687

Treasury Decisions:

9024, 2003-5 I.R.B. 365
9025, 2003-5 I.R.B. 362

Treasury Decisions—Continued:

9026, 2003-5 I.R.B. 366
9027, 2003-6 I.R.B. 413
9028, 2003-6 I.R.B. 415
9029, 2003-6 I.R.B. 403
9030, 2003-8 I.R.B. 495
9031, 2003-8 I.R.B. 504
9032, 2003-7 I.R.B. 471
9033, 2003-7 I.R.B. 483
9034, 2003-7 I.R.B. 453
9035, 2003-9 I.R.B. 528
9036, 2003-9 I.R.B. 533
9037, 2003-9 I.R.B. 535
9038, 2003-9 I.R.B. 524
9039, 2003-10 I.R.B. 561
9040, 2003-10 I.R.B. 568
9041, 2003-8 I.R.B. 510
9042, 2003-10 I.R.B. 564
9043, 2003-12 I.R.B. 611
9044, 2003-14 I.R.B. 690
9045, 2003-12 I.R.B. 610
9046, 2003-12 I.R.B. 614
9047, 2003-14 I.R.B. 676
9048, 2003-13 I.R.B. 644
9049, 2003-14 I.R.B. 685
9050, 2003-14 I.R.B. 693

¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2002-26 through 2002-52 is in Internal Revenue Bulletin 2003-1, dated January 6, 2003.

Finding List of Current Actions on Previously Published Items²

Bulletins 2003–1 through 2003–14

Notices:

97–19

Modified by
Rev. Proc. 2003–1, 2003–1 I.R.B. *1*

2001–26

Obsoleted by
T.D. 9032, 2003–7 I.R.B. *471*

2001–46

Modified by
Notice 2003–6, 2003–3 I.R.B. *298*

2001–69

Modified and superseded by
Notice 2003–1, 2003–2 I.R.B. *257*

2002–27

Clarified by
Notice 2003–3, 2003–2 I.R.B. *258*

2002–40

Modified by
Ann. 2003–18, 2003–13 I.R.B. *675*

2002–46

Modified by
Notice 2003–10, 2003–5 I.R.B. *369*

Proposed Regulations:

REG–209500–86

Corrected by
Ann. 2003–6, 2003–6 I.R.B. *450*

REG–103829–99

Corrected by
Ann. 2003–12, 2003–10 I.R.B. *585*

REG–126485–01

Withdrawn by
REG–126485–01, 2003–9 I.R.B. *542*

REG–143321–02

Corrected by
Ann. 2003–12, 2003–10 I.R.B. *585*

REG–164464–02

Corrected by
Ann. 2003–6, 2003–6 I.R.B. *450*

Revenue Procedures:

83–23

Supplemented by
Rev. Proc. 2003–21, 2003–6 I.R.B. *448*

84–37

Modified by
Rev. Proc. 2003–1, 2003–1 I.R.B. *1*

93–38

Obsoleted by
Rev. Proc. 2003–15, 2003–4 I.R.B. *321*

Revenue Procedures—Continued:

97–31

Modified by
Rev. Proc. 2003–9, 2003–8 I.R.B. *516*

98–13

Obsoleted by
T.D. 9032, 2003–7 I.R.B. *471*

2002–1

Superseded by
Rev. Proc. 2003–1, 2003–1 I.R.B. *1*

2002–2

Superseded by
Rev. Proc. 2003–2, 2003–1 I.R.B. *76*

2002–3

Superseded by
Rev. Proc. 2003–3, 2003–1 I.R.B. *113*

2002–4

Superseded by
Rev. Proc. 2003–4, 2003–1 I.R.B. *123*

2002–5

Superseded by
Rev. Proc. 2003–5, 2003–1 I.R.B. *163*

2002–6

Superseded by
Rev. Proc. 2003–6, 2003–1 I.R.B. *191*

2002–7

Superseded by
Rev. Proc. 2003–7, 2003–1 I.R.B. *233*

2002–8

Superseded by
Rev. Proc. 2003–8, 2003–1 I.R.B. *236*

2002–9

Modified and amplified by
Rev. Proc. 2003–20, 2003–6 I.R.B. *445*
Rev. Rul. 2003–3, 2003–2 I.R.B. *252*

2002–20

Supplemented by
Rev. Proc. 2003–26, 2003–13 I.R.B. *666*

2002–22

Modified by
Rev. Proc. 2003–3, 2003–1 I.R.B. *113*

2002–29

Modified by
Rev. Proc. 2003–10, 2003–2 I.R.B. *259*

2002–52

Modified by
Rev. Proc. 2003–1, 2003–1 I.R.B. *1*

2002–67

Supplemented by
Ann. 2003–3, 2003–4 I.R.B. *361*

2002–75

Superseded by
Rev. Proc. 2003–3, 2003–1 I.R.B. *113*

Revenue Procedures—Continued:

2003–3

Amplified by
Rev. Proc. 2003–14, 2003–4 I.R.B. *319*

2003–7

Corrected by
Ann. 2003–4, 2003–5 I.R.B. *396*

Revenue Rulings:

53–131

Modified by
Rev. Rul. 2003–12, 2003–3 I.R.B. *283*

57–190

Obsoleted by
Rev. Rul. 2003–18, 2003–7 I.R.B. *467*

65–190

Revoked by
Rev. Rul. 2003–3, 2003–2 I.R.B. *252*

69–372

Revoked by
Rev. Rul. 2003–3, 2003–2 I.R.B. *252*

92–19

Supplemented in part by
Rev. Rul. 2003–24, 2003–10 I.R.B. *557*

2003–2

Revoked by
Rev. Rul. 2003–22, 2003–8 I.R.B. *494*

Treasury Decisions:

9002

Corrected by
Ann. 2003–8, 2003–6 I.R.B. *451*

9021

Corrected by
Ann. 2003–16, 2003–12 I.R.B. *641*

9022

Supplemented by
Ann. 2003–7, 2003–6 I.R.B. *450*
Corrected by
Ann. 2003–11, 2003–10 I.R.B. *585*

² A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2002–26 through 2002–52 is in Internal Revenue Bulletin 2003–1, dated January 6, 2003.