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

INCOME TAX
Low-income housing credit; satisfactory bond; "bond factor" amounts for the period July through September 2004. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2004.

T.D. 9137, page 308.
Final regulations under section 460 of the Code provide guidance regarding the income tax consequences of certain partnership transactions involving contracts accounted for under a long-term contract method of accounting.

This notice solicits public comments concerning whether the existing final regulations under section 423 of the Code, concerning options granted under an employee stock purchase plan, should be amended.


EMPLOYEE PLANS
Final regulations under section 408(q) of the Code provide requirements relating to deemed IRAs that may be included in qualified employer plans, which are plans described in sections 401(a), 403(a), 403(b), and governmental plans under section 457(b). The regulations also amend section 408(a) with regard to the requirements under section 408(a) for non-bank trustees for deemed IRAs. Temporary and proposed regulations under section 408(a) provide that the Commissioner may, in his discretion, allow governmental entities to act as qualified non-bank trustees for deemed IRAs which are part of the entities’ qualified employer plan within the meaning of section 408(q).

EMPLOYMENT TAX
This procedure explains both the standard procedure and an alternate procedure for preparing and filing Form W–2, Wage and Tax Statement; Form 941, Employer’s Quarterly Federal Tax Return; Form W–4, Employee’s Withholding Allowance Certificate; and Form W–5, Earned Income Credit Advance Payment Certificate, in certain acquisitions. It also provides guidance on the new schedule (Schedule D (Form 941), Report of Discrepancies Caused by Acquisitions, Statutory Mergers, or Consolidations) that employers will be able to use to explain discrepancies between Forms W–2 and 941. Rev. Proc. 96–60 superseded and Rev. Rul. 62–60 amplified.

(Continued on the next page)

ADMINISTRATIVE


Low-income housing tax credit. This procedure publishes the amounts of unused housing credit carryovers allocated to qualified states under section 42(h)(3)(D) of the Code for calendar year 2004.

This procedure provides the domestic asset/liability percentages and domestic investment yield percentages needed by foreign insurance companies to compute their minimum effectively connected net investment income for taxable years beginning after December 31, 2002.
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 compiled 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:

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

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

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

Part IV.—Items of General Interest.
This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.
#### Part I. Rulings and Decisions Under the Internal Revenue Code of 1986

**Section 42.—Low-Income Housing Credit**

Low-income housing credit; satisfactory bond; “bond factor” amounts for the period July through September 2004. This ruling announces the monthly bond factor amounts to be used by taxpayers who dispose of qualified low-income buildings or interests therein during the period July through September 2004.

**Rev. Rul. 2004–89**

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

Rev. Proc. 99–11, 1999–1 C.B. 275, established a collateral program as an alternative to providing a surety bond for taxpayers to avoid or defer recapture of the low-income housing tax credits under § 42(j)(6). Under this program, taxpayers may establish a Treasury Direct Account and pledge certain United States Treasury securities to the Internal Revenue Service as security.

This revenue ruling provides in Table 1 the bond factor amounts for calculating the amount of bond considered satisfactory under § 42(j)(6) or the amount of United States Treasury securities to pledge in a Treasury Direct Account under Rev. Proc. 99–11 for dispositions of qualified low-income buildings or interests therein during the period July through September 2004.

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Section 408.—Individual Retirement Accounts


T.D. 9142

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

Deemed IRAs in Qualified Retirement Plans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations providing guidance under section 408(q) regarding accounts or annuities that are part of qualified employer plans but are to be treated as individual retirement plans. These regulations reflect changes made to the law by the Economic Growth and Tax Relief Reconciliation Act of 2001 and by the Job Creation and Worker Assistance Act of 2002. This document also contains temporary regulations under section 408(a) providing a special rule for governmental units seeking approval to serve as nonbank trustees of individual retirement accounts for purposes of section 408(q). These regulations affect administrators of, participants in, and beneficiaries of qualified employer plans.

DATES: Effective Date: These regulations are effective July 22, 2004. Applicability Dates: For dates of applicability, see §§1.408(q)–1(i) and 1.408–2T(e)(8)(iv).

FOR FURTHER INFORMATION CONTACT: Linda Conway at (202) 622–6090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507) under control number 1545–1841. Responses to this collection of information are required for taxpayers who want to include individual retirement plans as part of a qualified employer plan.

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

The estimated annual burden per respondent/recordkeeper is 50 hours.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W-CAR:MP:T:T:SP, Washington, DC 20224, and to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

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

Background

This document contains amendments to the Income Tax Regulations (26 CFR Part 1) under section 408(q) of the Internal Revenue Code (Code). On May 20, 2003, a notice of proposed rulemaking (REG–157302–02, 2003–1 C.B. 1021) was published in the Federal Register (68 FR 27493) under section 408(q). No public hearing was requested or held. Written comments responding to the notice of proposed rulemaking were received. After consideration of all the comments, the proposed regulations are adopted as amended by this Treasury decision.

This document also contains an amendment to the regulations under section 408(a) regarding the approval of nonbank trustees of individual retirement accounts. Section 1.408–2(e)(5)(v)(A) of the regulations currently provides that a person seeking approval to serve as a nonbank trustee must demonstrate that, except for investments pooled in a common investment fund, the investments of each account will not be commingled with any other property. Because section 408(q)(1) expressly provides that deemed IRAs need not satisfy the requirements of section 408(a)(5) regarding the commingling of IRA and plan assets, §1.408–2(e)(5)(v)(A) is modified to reflect the statutory rule.

In addition, this document contains a temporary amendment to the regulations under section 408(a) regarding the approval of nonbank trustees. This temporary amendment modifies the requirements for approval as a nonbank trustee for certain governmental units that intend to serve as the trustees of individual retirement accounts subject to section 408(q).

Explanation of Provisions and Summary of Comments

A. Overview

Section 408(q) provides that, if a qualified employer plan allows employees to make voluntary employee contributions to a separate account or annuity established under the plan and under the terms of the qualified employer plan the account or annuity meets the applicable requirements of section 408 or section 408A for an individual retirement account or annuity, then the account or annuity is treated for purposes of the Code in the same manner as an individual retirement plan rather than as a qualified employer plan. It further provides that contributions to such a “deemed IRA” are treated as contributions to the deemed IRA rather than to the qualified employer plan. Section 408(q) also expressly provides that the requirements of section 408(a)(5) regarding the commingling of IRA assets with other property shall not apply to deemed IRAs.

In general, the proposed regulations provided that a qualified employer plan and a deemed IRA would be treated as
Section 1.408(q)–1(f)(2) of the proposed regulations provided that any trust holding deemed individual retirement account assets must be separate from the trust holding the other assets of the qualified employer plan. The separate trust rule was intended to ensure better compliance with the IRA requirements and limit confusion of IRA and plan assets. The proposed regulations also provided a comparable rule for deemed IRAs that are individual retirement annuities.

Several commentators argued that a separate trust for deemed individual retirement accounts should not be required where the assets of the qualified employer plan are already held in a trust. They argued the plan’s trust could satisfy the requirement of section 408 that the individual retirement account be held in a trust and that separate accounting would ensure compliance with the IRA requirements and avoid any confusion of IRA and plan assets. They also argued that the requirement of a separate trust would unduly complicate the administration of the plan and lead to potentially higher costs for the plan sponsor. In response to these comments, the final regulations provide that a separate trust is not required in those cases in which the qualified employer plan maintains a trust but only if separate accounting is maintained for each deemed IRA. Revenue Procedure 2003–13, 2003–1 C.B. 317, which includes sample amendments providing for separate trusts for deemed IRAs, does not apply to the extent it provides to the contrary.

The regulations specify that if deemed IRAs are held in a single trust that includes the qualified employer plan, the trustee must maintain a separate account for each deemed IRA and the qualified employer plan.

Permitting deemed IRAs that are individual retirement accounts to be held in a single trust that includes the qualified employer plan raises the issue of whether, if the qualified employer plan portion of the trust invests in life insurance contracts, the deemed IRA would be considered to have violated section 408(a)(3), which provides that “no part of the trust funds will be invested in life insurance contracts.” The regulations clarify that, in that case, section 408(a)(3) is treated as satisfied if no part of the separate account of any of the deemed IRAs is invested in life insurance contracts.

Section 408A(b) and the regulations thereunder set forth rules under which a Roth IRA must be clearly designated as a Roth IRA. Pursuant to the regulations under §1.408A–2, Roth IRAs that are individual retirement accounts must be trusts separate from traditional IRAs. These final regulations permit a departure from these rules for deemed Roth IRAs, allowing them to be held in a single trust with deemed traditional IRAs, provided that the trustee maintains separate accounts for the deemed Roth IRAs and deemed traditional IRAs of each participant, and each of those accounts is clearly designated as such. Thus, the rules under §§1.408A–2 and 1.408A–4 of the regulations, regarding designation and redesignation of IRAs as Roth IRAs, apply to deemed IRAs as if the separate accounts maintained for the deemed Roth IRAs and deemed traditional IRAs were separate trusts.

The requirements for separate accounts within a trust as described above are not meant to imply that a trust that includes deemed IRAs and a qualified employer plan (or Roth and traditional IRAs) can be segmented for other purposes. For example, where a qualified employer plan and deemed IRAs are included in the same trust, there cannot be separate trustees for each account, and the trustee for the trust must be either a bank or a nonbank trustee that satisfies the requirements of section 408(a)(2) and the regulations thereunder.

The proposed regulations included a rule for individual retirement annuities similar to that for individual retirement accounts. Under the proposed regulations, separate annuity contracts were to be maintained for individual retirement annuities when the qualified employer plan also maintains annuity contracts. However, unlike the rules applicable to deemed individual retirement accounts which provide for separate accounts and not separate trusts, section 408(q)(1)(A) expressly provides that a separate annuity is to be established for a deemed individual retirement annuity. Accordingly, these final regulations retain the rule in the proposed regulations that a separate annuity is to be established under the plan with respect to deemed individual retirement annuities.

C. Disqualification

Section 1.408(q)–1(g) of the proposed regulations provided that the failure of any of the deemed IRAs maintained by the plan to satisfy the applicable requirements of section 408 or 408A caused the plan as a whole to fail to satisfy the plan’s qualification requirements. The proposed regulations further provided that, if the qualified employer plan failed to satisfy its qualification requirements, the deemed IRA portion would no longer be a deemed IRA because section 408(q) does not apply if the plan is not a qualified employer plan. The proposed regulations provided, however, that although the account or annuity that was intended to be a deemed IRA was no longer a deemed IRA, it could still be treated as a traditional or a Roth IRA if it satisfied the applicable requirements of section 408 or 408A (including the requirements regarding the commingling of assets under section 408(a)(5)).

Several commentators objected to this rule as inconsistent with the general rule that the qualified employer plan and the deemed IRA portion of the plan are separate entities and with the requirement that the deemed IRA assets and the other assets of the qualified employer plan must be maintained in separate trusts. Some commentators objected in particular to the rule that the failure of the qualification of a deemed IRA could result in the failure of the qualification of the plan as a whole. They stated that various aspects of the op-
eration of deemed IRAs are not within the control of the employer.

The final regulations provide that the failure of either the qualified employer plan portion or the deemed IRA portion of the plan to satisfy the applicable qualification rules of each will not cause the other portion to be automatically disqualified. This rule applies, however, only if the deemed IRA portion and the qualified employer plan portion are maintained as separate trusts (or separate annuity contracts, as required in the case of individual retirement annuities). If both the deemed IRA portion and the qualified plan portion are included in separate trusts and the qualified employer plan is disqualified, the IRA portion cannot be a deemed IRA under section 408(q) but it will not fail to satisfy the applicable requirements of section 408 or 408A if it satisfies the applicable requirements of those sections, including, with respect to individual retirement accounts, the requirements of section 408(a)(5). However, if the IRA assets and the non-IRA assets have been commingled (except in a common trust fund or common investment fund as permitted by section 408(a)(5)), the IRA portion will fail to satisfy the requirements of section 408(a).1 Likewise, if the IRA assets and the non-IRA assets are commingled (except as permitted by section 408(a)(5)), and the IRA is disqualified, the plan will also be disqualified.

D. Governmental Units as Nonbank Trustees

As noted above, the proposed regulations provided that a qualified employer plan and a related deemed IRA are generally treated as separate entities under the Code and each is subject to the rules applicable to that entity. Thus, under the proposed regulations, an individual retirement account that is a deemed IRA would be required to satisfy the requirements of section 408(a) except for the commingling limitations of section 408(a)(5). Consistent with this general rule, §1.408(q)–1(f)(1) of the proposed regulations provided that the trustee or custodian of an individual retirement account must be a bank or other person that receives approval from the Commissioner to serve as a nonbank trustee pursuant to §1.408–2(e) of the regulations.

Several commentators noted that because the nonbank trustee criteria were designed to test private entities, it is difficult, if not impossible, for most state and local governments to satisfy them. They also argued that, although it may be possible for a state or local government to appoint a bank or an approved nonbank trustee for the deemed IRA portion of the plan, this would impose unnecessary costs and administrative hardships on these governments that would outweigh any corresponding benefit and that such an appointment may contravene state law.

Several commentators argued that governments should be exempt from the nonbank trustee requirements, but the IRS and Treasury continue to believe that governments, like private entities, must demonstrate to the satisfaction of the Commissioner that the manner in which the government will administer the deemed IRA will be consistent with the requirements of section 408(a). Accordingly, the final regulations adopt the rule of the proposed regulations that the trustee of the deemed IRA must be a bank or a nonbank trustee approved by the Commissioner. The IRS and Treasury acknowledge, however, that §1.408–2(e) of the regulations sets forth several criteria that governments may have difficulty satisfying. Accordingly, this document temporarily amends §1.408–2(e) to provide that a governmental unit may serve as the trustee of any deemed IRA established by that governmental unit as part of its qualified employer plan if that governmental unit establishes to the satisfaction of the Commissioner that the manner in which it will administer the deemed IRA will be consistent with the requirements of section 408. The temporary amendment also provides special rules regarding the application of §1.408–2(e) to governmental units.

1 The Department of Labor has advised the IRS and Treasury that consistent with section 4(c) of the Employee Retirement Income Security Act (ERISA), accounts and annuities (and contributions thereto) established in accordance with section 408(q) of the Code are not to be treated as part of the pension plan under which such accounts and annuities are allowed (or as a separate pension plan) “for purposes of any provision of [title I of ERISA] other than § 403(c), 404, or 405 (relating to exclusive benefit, and fiduciary and co-fiduciary responsibilities) and part 5 (relating to administration and enforcement).” Accordingly, fiduciaries need to take appropriate steps to ensure that they satisfy any fiduciary duties associated with implementation and operation of a deemed IRA feature that is related to a plan covered under title I of ERISA. These duties may include, but are not limited to, a duty to monitor the activities of holders of deemed IRAs in order to prevent disqualification of the deemed IRA feature and/or the qualified employer plan where the plan is intended to be maintained as a tax-qualified plan.
rules of section 3405(c) do not apply to a distribution from the deemed IRA portion but would apply to a distribution from the qualified employer plan portion, and section 72(t) applies separately to the two portions.

Questions were also raised regarding who may participate in a deemed IRA. For example, one commentator, noting that the term employee is not defined by section 408(q) or by the proposed regulations, asked whether that term includes self-employed individuals. Although employee is not defined by section 408(q), section 408(q)(3)(B) defines a voluntary employee contribution, in part, as a contribution by an individual “as an employee under a qualified employer plan which allows employees” to elect to make contributions to a separate account under the plan. Thus, these regulations provide that to the extent a self-employed individual is an employee for purposes of the qualified employer plan, that individual will be treated as an employee for purposes of section 408(q). In the case of a qualified plan under section 401(a) and a qualified annuity plan under section 403(a), employee includes self-employed individuals as defined in section 401(c). The only circumstance under which a self-employed individual may participate in a section 403(b) plan is when a self-employed minister described in section 414(e)(5) participates in a retirement income account as described in section 403(b)(9). In contrast, section 457(e)(2) permits independent contractors as well as employees to participate in a section 457 plan. However, since section 408(q) permits only employees to make contributions to a deemed IRA, only employees (including self-employed individuals) may be permitted to participate in a deemed IRA maintained by a governmental section 457 plan.

Another commentator asked whether an employee can participate in a deemed IRA if he or she does not participate in the qualified employer plan, or even if the employee is not eligible to participate in the qualified employer plan. Again, as noted above, the deemed IRA and the qualified employer plan are generally treated as separate entities under the Code. Section 408(q) does not impose a requirement that an employee must participate in both portions of the plan or that an employee must be eligible to participate in both portions of the plan. Accordingly, the two portions of the plan may have different eligibility requirements.

One commentator asked whether the automatic enrollment principles applicable to section 401(k), 403(b), and 457 plans under Revenue Rulings 2000–8, 2000–1 C.B. 617; 2000–35, 2000–2 C.B. 138; and 2000–33, 2000–2 C.B. 142, apply to deemed IRAs. These revenue rulings specify the criteria to be met in order for an employee’s compensation to be automatically reduced by a certain amount where that amount is contributed as an elective deferral to these three types of plans. The IRS and Treasury agree that the automatic enrollment principles applicable to section 401(k), 403(b), and 457 plans in the cited revenue rulings may also be applied to deemed IRAs.

With respect to the requirements for approval as a nonbank trustee, one commentator noted that §1.408–2(e)(5)(v) requires that an applicant must demonstrate that, except for investments pooled in a common investment fund, the investments of each account will not be commingled with any other property. The commentator noted that this requirement is inconsistent with the provisions of section 408(q)(1), which provide that the requirements of section 408(a)(5) regarding commingling do not apply to deemed IRAs. Accordingly, this document amends §1.408–2(e)(5)(v) to provide that an applicant that intends to serve as a nonbank trustee need not satisfy this requirement with respect to any assets held in a deemed IRA.

Finally, these regulations provide that neither the assets held in the deemed IRA portion of the qualified employer plan, nor any benefits attributable thereto, shall be taken into account for purposes of determining the benefits of employees and their beneficiaries under the plan (within the meaning of section 401(a)(2)) or determining the plan’s assets or liabilities for purposes of section 404 or 412. The Pension Benefit Guaranty Corporation (PBGC) has advised the IRS and Treasury that a deemed IRA feature that is related to a qualified employer plan is not covered by Title IV of ERISA. The PBGC has further advised that the deemed IRA feature is treated as a separate entity from the qualified employer plan for purposes of Title IV. For example, neither the assets in, nor the benefits attributable to, the deemed IRA are taken into account in determining the amount of the PBGC’s variable-rate premium, and an individual who is a participant in the deemed IRA but who is not a participant in the qualified employer plan is not included in the PBGC’s flat-rate participant count. In addition, for purposes of Title IV, the deemed IRA will be treated as separate from the qualified employer plan in the event of termination of the qualified employer plan, and the fiduciary of the deemed IRA would continue to be responsible for the continued operation, transfer, or termination of the deemed IRA. The PBGC would allocate the assets of the qualified employer plan to the priority categories under section 4044 of ERISA without regard to any assets in, or benefits attributable to, the deemed IRA, and the PBGC would not serve as trustee of the deemed IRA. Termination of a deemed IRA would not be subject to the rules governing plan termination under Title IV of ERISA.

Effective Date

The regulations apply to accounts or annuities established under section 408(q) on or after August 1, 2003.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required.

It is hereby certified that the collection of information in these final regulations will not have a significant economic impact on a substantial number of small entities. The collection of information in the regulations is in §1.408(q)–1(f)(2) and consists of the optional requirement that deemed IRAs may be held in trusts or annuity contracts separate from the trust or annuity contract of the qualified employer plan. This certification is based on the fact that the burden of reporting these separate trusts and annuity contracts is small, particularly for small entities. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the
Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For the applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6) to the temporary regulations, refer to the Special Analyses section of the preamble to the cross-referencing notice of proposed rulemaking (REG–101447–04) published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding the final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. The temporary regulations will also be submitted to the Chief Counsel for Advocacy for such comment.

Drafting Information

The principal authors of these regulations are Robert Walsh of the Tax Exempt and Government Entities Division and Linda Conway, Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury participated in the development of these regulations.

* * * * *

Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

§1.408–2 also issued under 26 U.S.C. 408(a) and 26 U.S.C. 408(q). * * *

§1.408(q)–1 also issued under 26 U.S.C. 408(q). * * *

Par. 2. In §1.408–2, paragraph (e)(5) (v)(A) is revised and (e)(8) is added to read as follows:

§1.408–2 Individual retirement accounts

* * * *

(e) * * *

(5) * * *

(v) Custody of investments. (A) Except for investments pooled in a common investment fund in accordance with the provisions of paragraph (e)(5)(vi) of this section and for investments of accounts established under section 408(q) on or after August 1, 2003, the investments of each account will not be commingled with any other property.

* * * * *

(8) [Reserved]. For further guidance, see §1.408–2T(e)(8).

Par. 3. Section 1.408–2T is added to read as follows:

§1.408–2T Individual retirement accounts (temporary).

(a) through (e)(7) [Reserved]. For further guidance, see §1.408–2(a) through (e)(7).

(8) Special rules for governmental units. (i) A governmental unit that seeks to qualify as a nonbank trustee of a deemed IRA that is part of its qualified employer plan must demonstrate to the satisfaction of the Commissioner that it is able to administer the trust in a manner that is consistent with the requirements of section 408. The demonstration must be made by written application to the Commissioner. Notwithstanding the requirement of §1.408–2(e)(1) that a person must demonstrate by written application that the requirements of paragraphs (e)(2) to (e)(6) of that section will be met in order to qualify as a nonbank trustee, a governmental unit that maintains a plan qualified under section 401(a), 403(a), 403(b) or 457 need not demonstrate that all of these requirements will be met with respect to any individual retirement accounts maintained by that governmental unit pursuant to section 408(q). For example, a governmental unit need not demonstrate that it satisfies the net worth requirements of §1.408–2(e)(3)(ii) if it demonstrates instead that it possesses taxing authority under applicable law. The Commissioner, in his discretion, may exempt a governmental unit from certain other requirements upon a showing that the governmental unit is able to administer the deemed IRAs in the best interest of the participants. Moreover, in determining whether a governmental unit satisfies the other requirements of §1.408–2(e)(2) to (e)(6), the Commissioner may apply the requirements in a manner that is consistent with the applicant’s status as a governmental unit.

(ii) Governmental unit. For purposes of this special rule, the term governmental unit means a State, political subdivision of a State, and any agency or instrumentality of a State or political subdivision of a State.

(iii) Additional rules. The Commissioner may in revenue rulings, notices, or other guidance of general applicability provide additional rules for governmental units seeking approval as nonbank trustees.

(iv) Effective date. This special rule is applicable for written applications made on or after August 1, 2003, or such earlier application as the Commissioner deems appropriate.

Par. 4. Section 1.408(q)–1 is added to read as follows:

§1.408(q)–1 Deemed IRAs in qualified employer plans.

(a) In general. Under section 408(q), a qualified employer plan may permit employees to make voluntary employee contributions to a separate account or annuity established under the plan. If the requirements of section 408(q) and this section are met, such account or annuity is treated in the same manner as an individual retirement plan under section 408 or 408A (and contributions to such an account or annuity are treated as contributions to an individual retirement plan and not to the qualified employer plan). The account or annuity is referred to as a deemed IRA.

(b) Types of IRAs. If the account or annuity meets the requirements applicable to traditional IRAs under section 408, the account or annuity is deemed to be a traditional IRA, and if the account or annuity meets the requirements applicable to Roth IRAs under section 408A, the account or annuity is deemed to be a Roth IRA. Simplified employee pensions (SEPs) under section 408(k) and SIMPLE IRAs under section 408(p) may not be used as deemed IRAs.

(c) Separate entities. Except as provided in paragraphs (d) and (g) of this section, the qualified employer plan and the deemed IRA are treated as separate entities under the Internal Revenue Code.
and are subject to the separate rules applicable to qualified employer plans and IRAs, respectively. Issues regarding eligibility, participation, disclosure, nondiscrimination, contributions, distributions, investments, and plan administration are generally to be resolved under the separate rules (if any) applicable to each entity under the Internal Revenue Code.

(d) Exceptions. The following exceptions to treatment of a deemed IRA and the qualified employer plan as separate entities apply:

(1) The plan document of the qualified employer plan must contain the deemed IRA provisions and a deemed IRA must be in effect at the time the deemed IRA contributions are accepted. Notwithstanding the preceding sentence, employers that provided deemed IRAs for plan years beginning before January 1, 2004, (but after December 31, 2002) are not required to have such provisions in their plan documents before the end of such plan years.

(2) The requirements of section 408(a)(5) regarding commingling of assets do not apply to deemed IRAs. Accordingly, the assets of a deemed IRA may be commingled for investment purposes with those of the qualified employer plan. However, the restrictions on the commingling of plan and IRA assets with other assets apply to the assets of the qualified employer plan and the deemed IRA.

(e) Application of distribution rules.

(1) Rules applicable to distributions from qualified employer plans under the Internal Revenue Code and regulations do not apply to distributions from deemed IRAs. Instead, the rules applicable to distributions from IRAs apply to distributions from deemed IRAs. Also, any restrictions that a trustee, custodian, or insurance company is permitted to impose on distributions from traditional and Roth IRAs may be imposed on distributions from deemed IRAs (for example, early withdrawal penalties on annuities).

(2) The required minimum distribution rules of section 401(a)(9) must be met separately with respect to the qualified employer plan and the deemed IRA. The determination of whether a qualified employer plan satisfies the required minimum distribution rules of section 401(a)(9) is made without regard to whether a participant satisfies the required minimum distribution requirements with respect to the deemed IRA that is established under such plan.

(3) Annuity contracts. Deemed IRAs that are individual retirement annuities may be held under a single annuity contract or under separate annuity contracts. However, the contract must be separate from any annuity contract or annuity contracts of the qualified employer plan. In addition, the contract must satisfy the requirements of section 408(b) and there must be separate accounting for the interest of each participant in those cases where the individual retirement annuities are held under a single annuity contract.

(4) Deductibility. The deductibility of voluntary employee contributions to a traditional deemed IRA is determined in the same manner as if they were made to any other traditional IRA. Thus, for example, taxpayers with compensation that exceeds the limits imposed by section 219(g) may not be able to make contributions to deemed IRAs, or the deductibility of such contributions may be limited in accordance with sections 408 and 219(g). However, section 219(f)(5), regarding the taxable year in which amounts paid by an employer to an individual retirement plan are includible in the employee’s income, is not applicable to deemed IRAs.

(5) Rollovers and transfers. The same rules apply to rollovers and transfers to and from deemed IRAs as apply to rollovers and transfers to and from other IRAs. Thus, for example, the plan may provide that an employee may request and receive a distribution of his or her deemed IRA account balance and may roll it over to an eligible retirement plan in accordance with section 408(d)(3), regardless of whether that employee may receive a distribution of any other plan benefits.

(6) Nondiscrimination. The availability of a deemed IRA is not a benefit, right or feature of the qualified employer plan under §1.401(a)(4)–4.

(7) IRA assets and benefits not taken into account in determining benefits under or funding of qualified employer plan. Neither the assets held in the deemed IRA portion of the qualified employer plan, nor any benefits attributable thereto, shall be taken into account for purposes of:

(i) determining the benefits of employees and their beneficiaries under the plan (within the meaning of section 401(a)(2)); or

(ii) determining the plan’s assets or liabilities for purposes of section 404 or 412.

(g) Disqualifying defects — (1) Single trust. If the qualified employer plan fails to satisfy the qualification requirements applicable to it, either in form or operation, any deemed IRA that is an individual retirement account and that is included as...
part of the trust of that qualified employer plan does not satisfy section 408(q). Accordingly, any account maintained under such a plan as a deemed IRA ceases to be a deemed IRA at the time of the disqualifying event. In addition, the deemed IRA also ceases to satisfy the requirements of sections 408(a) and 408A. Also, if any one of the deemed IRAs fails to satisfy the applicable requirements of sections 408 or 408A, and the assets of that deemed IRA are included as part of the trust of the qualified employer plan, section 408(q) does not apply and the plan will fail to satisfy the plan’s qualification requirements.

(2) Separate trusts and annuities. If the qualified employer plan fails to satisfy its qualification requirements, either in form or operation, but the assets of a deemed IRA are held in a separate trust (or where a deemed IRA is an individual retirement annuity), then the deemed IRA does not automatically fail to satisfy the applicable requirements of section 408 or 408A. Instead, its status as an IRA will be determined by considering whether the account or the annuity satisfies the applicable requirements of sections 408 and 408A (including, in the case of individual retirement accounts, the prohibition against the commingling of assets under section 408(a)(5)). Also, if a deemed IRA fails to satisfy the requirements of a qualified IRA and the assets of the deemed IRA are held in a separate trust (or where the deemed IRA is an individual retirement annuity), the qualified employer plan will not fail the qualification requirements applicable to it under the Code solely because of the failure of the deemed IRA.

(h) Definitions. The following definitions apply for purposes of this section:

(1) Qualified employer plan. A qualified employer plan is a plan described in section 401(a), an annuity plan described in section 403(a), a section 403(b) plan, or a governmental plan under section 457(b).

(2) Voluntary employee contribution. A voluntary employee contribution is any contribution (other than a mandatory contribution within the meaning of section 411(c)(2)(C)) which is made by an individual as an employee under a qualified employer plan that allows employees to elect to make contributions to deemed IRAs and with respect to which the individual has designated the contribution as a contribution to which section 408(q) applies.

(3) Employee. An employee includes any individual who is an employee under the rules applicable to the qualified employer plan under which the deemed IRA is established.

(i) Effective date. This section applies to accounts or annuities established under section 408(q) on or after August 1, 2003.

PART 602 — OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 5. The authority citation for part 602 continues to read as follows:
Authority: 26 U.S.C. 7805. * * *

Par. 6. In § 602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

<table>
<thead>
<tr>
<th>CFR part or section where</th>
<th>Current OMB</th>
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</thead>
<tbody>
<tr>
<td>identified and described</td>
<td>control No.</td>
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<td>* * * * * * * * * * * * *</td>
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<tr>
<td>1.408(q)–1</td>
<td>1545–1841</td>
</tr>
</tbody>
</table>

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


Gregory F. Jenner,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 21, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 22, 2004, 69 F.R. 43735)
Background

Section 460 of the Internal Revenue Code generally requires that taxpayers determine taxable income from a long-term contract using the percentage-of-completion method (PCM). Under regulations finalized in 2001 (T.D. 8929, 2001–1 C.B. 756), a taxpayer using the PCM generally includes a portion of the total contract price in income for each taxable year that the taxpayer incurs contract costs allocable to the long-term contract. More specifically, to determine the income from a long-term contract, the taxpayer first computes the completion factor for the contract, which is the percentage of the estimated total allocable contract costs that the taxpayer has incurred (based on the all events test of section 461, including economic performance, regardless of the taxpayer’s method of accounting) through the end of the taxable year. Second, the taxpayer computes the amount of cumulative gross receipts from the contract by multiplying the completion factor by the total contract price, which is the amount that the taxpayer reasonably expects to receive under the contract. Third, the taxpayer computes the amount of current-year gross receipts, which is the difference between the cumulative gross receipts for the current taxable year and the cumulative gross receipts for the immediately preceding taxable year. This difference may be a loss (a negative number) based on revisions to estimates of total allocable contract costs or total contract price. Fourth, the taxpayer takes into account both the current-year gross receipts and the amount of allocable contract costs actually incurred during the taxable year. To the extent any portion of the total contract price has not been included in taxable income by the completion year, section 460(b)(1) and the regulations require the taxpayer to include that portion in income for the taxable year following the completion year.

A long-term contract or a portion of a long-term contract that is exempt from the PCM may be accounted for under any permissible method, including the completed contract method (CCM). Under the CCM, a taxpayer does not take into account the gross contract price and allocable contract costs until the contract is complete, even though progress payments are received in years prior to completion.

A taxpayer generally must allocate costs to a contract subject to section 460(a) in the same manner as direct and indirect costs are capitalized to property produced by a taxpayer under section 263A. The regulations provide exceptions, however, that reflect the differences in the cost allocation rules of sections 263A and 460.

Section 460(b) directs the Secretary to prescribe regulations to the extent necessary or appropriate to carry out the purpose of section 460, including regulations to prevent a taxpayer from avoiding section 460 by using related parties, pass-through entities, intermediaries, options, and other similar arrangements.

On May 15, 2002, final regulations under section 460 were issued to address a mid-contract change in taxpayer engaged in completing a contract accounted for under a long-term contract method of accounting (T.D. 8995, 2002–1 C.B. 1070). The regulations divide the rules regarding a mid-contract change in taxpayer into two categories-constructive completion transactions and step-in-the-shoes transactions.

In a constructive completion transaction, the taxpayer that originally accounted for the long-term contract (old taxpayer) must recognize income from the contract as of the time of the transaction. The contract price used to determine the amount of income recognized by the taxpayer is the amount realized from the transaction, reduced by any amounts paid by the old taxpayer to the taxpayer subsequently accounting for the long-term contract (new taxpayer) that are allocable to the contract. Similarly, the new taxpayer in a constructive completion transaction is treated as though it entered into a new contract as of the date of the transaction. The new taxpayer’s contract price is the amount that the new taxpayer reasonably expects to receive under the contract, reduced by the price paid by the new taxpayer for the contract, and increased by any amounts paid by the old taxpayer to the new taxpayer that are allocable to the contract. In contrast, in a step-in-the-shoes transaction, the old taxpayer’s obligation to account for the contract terminates on the date of the transaction and is assumed by the new taxpayer. The new taxpayer must assume the old taxpayer’s methods of accounting for the contract, with both the contract price and allocable contract costs based on amounts taken into account by both parties.

The final section 460 regulations provide that a contribution to a partnership in a transaction described in section 721(a), a transfer of a partnership interest, and a distribution by a partnership to which section 731 applies (other than a distribution of a contract accounted for under a long-term contract method of accounting) are step-in-the-shoes transactions. In a notice issued concurrently with the final regulations, Notice 2002–37, 2002–23 I.R.B. 1095, the Treasury Department and IRS announced their intention to publish regulations setting forth the special rules that apply to these partnership transactions and described many of these rules. The notice further provided that these regulations would apply to contributions, transfers, and distributions occurring on or after May 15, 2002. On August 6, 2003, a notice of proposed rulemaking (REG–128203–02, 2003–41 I.R.B. 828) relating to partnership transactions involving contracts accounted for under a long-term contract method of accounting was published in the Federal Register (68 FR 46516). Comments were received from the public in response to the notice of proposed rulemaking. No public hearing was requested or held. After consideration of all comments, the proposed regulations are adopted as amended by this Treasury decision.

Explanation and Summary of Contents

The regulations proposed on August 6, 2003, provide that the constructive completion rules do not apply to a transfer by a partnership (transferor partnership) of all of its assets and liabilities to a second partnership (transferee partnership) in an exchange described in section 721, followed by a distribution of the interest in the transferee partnership in liquidation of the transferee partnership, under §1.708–1(b)(4) (relating to terminations under section 708(b)(1)(B)) or §1.708–1(c)(3)(i) (relating to certain partnership mergers). One commentator suggested clarifying that the constructive completion rules apply to other distributions of an interest in a partnership (lower-tier partnership) holding one or more contracts accounted for under a
long-term contract method of accounting by another partnership (upper-tier partnership). This comment has been adopted.

One commentator suggested that the final regulations clarify the application of the constructive completion rules if a partnership that holds a contract accounted for under a long-term contract method of accounting terminates under section 708(b)(1)(A) because the number of its owners is reduced to one. In response to this comment, the final regulations provide that the entire contract will be treated as being distributed from the partnership for purposes of the constructive completion rules, because the partnership ceases to exist for tax purposes. In addition, the final regulations provide that the partnership must apply the constructive completion rules immediately prior to the transaction or transactions resulting in the termination of the partnership.

Consistent with §1.706–1(c)(2)(ii), the proposed regulations generally provide that upon the transfer or liquidation of an interest in a partnership holding a contract accounted for under a long-term contract method of accounting, the step-in-the-shoes rules apply to a contract accounted for under a long-term contract method of accounting only if the partnership’s books are properly closed with respect to that contract under section 706. The proposed regulations provide that if the partnership’s books are not closed with respect to the contract, the partnership shall compute its income or loss from each contract accounted for under a long-term contract method of accounting for the period that includes the date of the transfer or liquidation as though no change in taxpayer had occurred with respect to that contract, and may pro rate income from the contract under a reasonable method complying with section 706. The proposed regulations also provide similar rules for distributions of property (other than a contract accounted for under a long-term contract method of accounting) from a partnership holding a long-term contract, and for contributions of property (other than a contract accounted for under a long-term contract method of accounting) to a partnership holding a contract accounted for under a long-term contract method of accounting.

The proposed regulations requested comments regarding whether similar rules should be provided with respect to transfers of stock in an S corporation holding a contract accounted for under a long-term contract method of accounting. Under section 1377(a)(1) and §1.1377–1(a), each shareholder’s pro rata share of any S corporation item for any taxable year is generally the sum of the amounts determined with respect to the shareholder by assigning an equal portion of the item to each day of the S corporation’s taxable year, and then dividing that portion pro rata among the shares outstanding on that day. Under section 1377(a)(2) and §1.1377–1(b), an S corporation may elect to close its books if a shareholder’s entire interest in an S corporation is terminated during the S corporation’s taxable year, and the corporation and all affected shareholders agree. No comments were received.

The Treasury Department and IRS have concluded that similar rules should be provided for transfers of S corporation stock and conversions to and from S corporation status. Thus, the final regulations generally provide that upon the transfer of stock in an S corporation holding a contract accounted for under a long-term contract method of accounting, or the conversion to or from S corporation status by a corporation holding such a contract, the step-in-the-shoes rules apply to the contract only if the S corporation’s books are closed under section 1362(e)(3), section 1362(e)(6)(C), section 1362(e)(6)(D), section 1377(a)(2), or §1.1502–76. If the S corporation’s books are not closed, the S corporation computes its income or loss from the contract for the period that includes the date of the transfer as though no change in taxpayer had occurred with respect to the contract, and must pro rate income from the contract in accordance with the rules generally applicable to such transfers or conversions.

In Rev. Rul. 73–301, 1973–2 C.B. 215, the IRS ruled that the progress payments described in the ruling did not constitute a liability within the meaning of section 752. See also Rev. Rul. 81–241, 1981–2 C.B. 146 (citing and following Rev. Rul. 73–301). The proposed regulations requested comments regarding whether there are circumstances under which the receipt of progress payments under a contract accounted for under a long-term contract method of accounting could give rise to a liability under section 752, and, if so, how the regulations would need to be revised to account for such liabilities. No written comments were received. However, if a contract accounted for under a long-term contract method of accounting is contributed to a partnership, then, to the extent that progress payments give rise to a liability, section 752(b) would require the transferring partner to reduce its basis in its partnership by the amount of that liability, either when the contract is contributed (to the extent that the liability is allocated to other partners) or when the liability is extinguished. Thus, because the proposed regulations require the partner to reduce the partner’s basis in its partnership interest by the amount of progress payments received, the proposed regulations could require two reductions in basis for the same payments.

Ordinarily, progress payments do not give rise to liabilities within the meaning of section 752 and the regulations thereunder. However, to the extent that there is a case in which a progress payment gives rise to such a liability, the Treasury Department and IRS agree that taxpayers should not be required to reduce their basis twice for the same progress payment, and believe that a similar rule should be provided for transfers to corporations. Accordingly, upon a contribution of a contract accounted for under a long-term contract method of accounting to a partnership or corporation, the final regulations provide that the required reduction in basis for progress payments received does not apply to the extent that such progress payments give rise to a liability (other than a liability described in section 357(c)(3)).

Finally, one commentator suggested that the regulations clarify that the fair market value of a contract contributed to a partnership does not necessarily equal the full amount of expected remaining profit on the contributed contract. The Treasury Department and IRS believe that it is sufficiently clear under the proposed regulations that the fair market value of the contributed contract is determined under general tax principles. Thus, this comment has not been adopted.

Special Analysis

It has been determined that this Treasury decision is not a significant regula-
Drafting Information

The principal authors of these regulations are Matthew Lay and Richard Probst of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, personnel from other offices of the Treasury Department and IRS participated in their development.

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.460–0 is amended as follows:

1. Revising the entry for paragraph 1.460–4(k)(2)(iv).
2. Adding entries for §1.460–4(k)(2) (iv)(A) through (E).
4. Revising the entry for §1.460–4(k)(3)(iv)(A)(2) and adding entries for §1.460–4(k)(3)(iv)(C) and (D).
5. Revising the entry for §1.460–4(k)(3)(v).
7. Adding entries for §1.460–6(g)(3)(ii)(D)(1) and (2).

The additions and revisions read as follows:

§1.460–0 Outline of regulations under section 460.

* * * * *

§1.460–4 Methods of accounting for long-term contracts.

* * * * *

(k) * * *

(2) * * *

(iv) Special rules relating to distributions of certain contracts by a partnership.

(A) In general.

(B) Old taxpayer.

(C) New taxpayer.

(D) Basis rules.

(E) Section 751.

(l) In general.

(2) Ordering rules.

(3) * * *

(iv) Special rules related to certain corporate and partnership transactions.

(A) * * *

(2) Basis adjustment in excess of stock or partnership interest basis.

* * * * *

(C) Definition of old taxpayer and new taxpayer for certain partnership transactions.

(D) Exceptions to step-in-the-shoes rules for S corporations.

(v) Special rules relating to certain partnership transactions.

(A) Section 704(c).

(l) Contributions of contracts.

(2) Revaluations of partnership property.

(3) Allocation methods.

(B) Basis adjustments under sections 743(b) and 734(b).

(C) Cross reference.

(D) Exceptions to step-in-the-shoes rules.

* * * * *

§1.460–6 Look-back method.

* * * * *

(g) * * *

(3) * * *

(ii) * * *

(D) * * *

(l) In general.

(2) Special rules for certain pass-through entity transactions.

* * * * *

Par. 3. Section 1.460–4 is amended as follows:

1. Revising the sixth sentence in paragraph (k)(1).

2. Revising paragraph (k)(2)(iv).

3. Removing the first word “The” in paragraph (k)(3)(i), adding in its place “Except as otherwise provided in paragraph (k)(3)(v)(D) of this section, the”.


5. Redesignating paragraphs (k)(3)(i)(J), (K) and (L) as paragraphs (k)(3)(i)(K), (L) and (M), respectively.


10. Adding paragraph (k)(5) Example 9 through Example 13.

11. Revising the first sentence in paragraph (k)(6).

The additions and revisions read as follows:

§1.460–4 Methods of accounting for long-term contracts.

* * * * *

(k) * * *

(1) * * * Special rules relating to the treatment of certain partnership transactions are provided in paragraphs (k)(2)(iv) and (k)(3)(v) of this section. * * * *

(2) * * *

(iv) Special rules relating to distributions of certain contracts by a partnership — (A) In general. The constructive completion rules of paragraph (k)(2) of this section apply both to the distribution of a contract accounted for under a long-term contract method of accounting by a partner to a partner and to the distribution of an interest in a partnership (lower-tier partnership) holding (either directly or through other partnerships) one or more contracts accounted for under a long-term contract method of accounting by another partnership (upper-tier partnership). Notwithstanding the previous sentence, the constructive completion rules of paragraph (k)(2) of this section do not apply to a transfer by a partnership (transferor partnership) of all of its assets and liabilities to a second partnership (transferee partnership) in an exchange described in
section 721, followed by a distribution of the interest in the transferee partnership in liquidation of the transferor partnership, under §1.708–1(b)(4) (relating to terminations under section 708(b)(1)(B)) or §1.708–1(c)(3)(i) (relating to certain partnership mergers). If a partnership that holds a contract accounted for under a long-term contract method of accounting terminates under section 708(b)(1)(A) because the number of its owners is reduced to one, the entire contract will be treated as being distributed from the partnership for purposes of the constructive completion rules, and the partnership must apply paragraph (k)(2) of this section immediately prior to the transaction or transactions resulting in the termination of the partnership. 

(B) Old taxpayer. The partnership that distributes the contract is treated as the old taxpayer for purposes of paragraph (k)(2)(ii) of this section. For purposes of determining the total contract price (or gross contract price) under paragraph (k)(2)(ii) of this section, the fair market value of the contract is treated as the amount realized from the transaction. For purposes of determining each partner’s distributive share of partnership items, any income or loss resulting from the constructive completion must be allocated among the partners of the old taxpayer as though the partnership closed its books on the date of the distribution.

(C) New taxpayer. The partner receiving the distributed contract is treated as the new taxpayer for purposes of paragraph (k)(2)(iii) of this section. For purposes of determining the total contract price (or gross contract price) under paragraph (k)(2)(iii) of this section, the new taxpayer’s basis in the contract (including the uncompleted property, if applicable) after the distribution (as determined under section 732) is treated as consideration paid by the new taxpayer that is allocable to the contract. Thus, the total contract price (or gross contract price) of the new contract is reduced by the partner’s basis in the contract (including the uncompleted property, if applicable) immediately after the distribution.

(D) Basis rules. For purposes of determining the new taxpayer’s basis in the contract (including the uncompleted property, if applicable) under section 732, and the amount of any basis adjustment under section 734(b), the partnership’s basis in the contract (including the uncompleted property, if applicable) immediately prior to the distribution is equal to—

(1) The partnership’s allocable contract costs (including transaction costs);

(2) Increased (or decreased) by the amount of cumulative taxable income (or loss) recognized by the partnership on the contract through the date of the distribution (including amounts recognized as a result of the constructive completion); and

(3) Decreased by the amounts that the partnership has received or reasonably expects to receive under the contract.

(E) Section 751 — (1) In general. Contracts accounted for under a long-term contract method of accounting are unrealized receivables within the meaning of section 751(c). For purposes of section 751, the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting is the amount of income or loss that the partnership would take into account under the constructive completion rules of paragraph (k)(2) of this section if the contract were disposed of for its fair market value in a constructive completion transaction, adjusted to account for any income or loss from the contract that is allocated under section 706 to that portion of the taxable year of the partnership ending on the date of the distribution, sale, or exchange.

(2) Ordering rules. Because the distribution of a contract accounted for under a long-term contract method of accounting is the distribution of an unrealized receivable, section 751(b) may apply to the distribution. A partnership that distributes a contract accounted for under a long-term contract method of accounting must apply paragraph (k)(2)(ii) of this section before applying the rules of section 751(b) to the distribution.

(I) Contributions of contracts accounted for under a long-term contract method of accounting to which section 721(a) applies:

(1) Contributions of property (other than contracts accounted for under a long-term contract method of accounting) to a partnership that holds a contract accounted for under a long-term contract method of accounting;

(K) Transfers of partnership interests (other than transfers which cause the partnership to terminate under section 708(b)(1)(A));

(iv) Special rules related to certain corporate and partnership transactions — (A) Old taxpayer — basis adjustment — (i) In general. Except as provided in paragraph (k)(3)(iv)(A)(2) of this section, in the case of a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section, the old taxpayer must adjust its basis in the stock or partnership interest of the new taxpayer by—

(ii) Increasing such basis by the amount of gross receipts the old taxpayer has recognized under the contract; and

(ii) Reducing such basis by the amount of gross receipts the old taxpayer has received or reasonably expects to receive under the contract (except to the extent such gross receipts give rise to a liability other than a liability described in section 357(c)(3)).

(2) Basis adjustment in excess of stock or partnership interest basis. If the old and new taxpayer do not join in the filing of a consolidated Federal income tax return, the old taxpayer may not adjust its basis in the stock or partnership interest of the new taxpayer under paragraph (k)(3)(iv)(A)(I) of this section below zero and the old taxpayer must recognize ordinary income to the extent the basis in the stock or partnership interest of the new taxpayer otherwise would be adjusted below zero. If the old and new taxpayer join in the filing of a consolidated Federal income tax return, the old taxpayer must create an (or increase an existing) excess loss account to the extent the basis in the stock of the new taxpayer otherwise would be adjusted below zero under paragraph (k)(3)(iv)(A)(I) of this section. See §§1.1502–19 and 1.1502–32(a)(3)(ii).

(3) Subsequent dispositions of certain contracts. If the old taxpayer disposes of a contract in a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section that the old taxpayer acquired in a transaction described in paragraph (k)(3)(i)(D), (E), or (I) of this section, the basis adjustment rule of this paragraph (k)(3)(iv)(A) is applied by treating the old taxpayer as having recognized the amount of gross receipts recognized by the previous old tax-
payers under the contract and any amount recognized by the previous old taxpayer with respect to the contract in connection with the transaction in which the old taxpayer acquired the contract. In addition, the old taxpayer is treated as having received or as reasonably expecting to receive under the contract any amount the previous old taxpayer received or reasonably expects to receive under the contract. Similar principles will apply in the case of multiple successive transfers described in paragraph (k)(3)(i)(D), (E), or (I) of this section involving the contract.

(B) New Taxpayer — (1) Contract price adjustment. Generally, payments between the old taxpayer and the new taxpayer with respect to the contract in connection with the transaction do not affect the contract price. Notwithstanding the preceding sentence and paragraph (k)(3)(iii)(B) of this section, however, in the case of transactions described in paragraph (k)(3)(iii)(B), (D), (E), or (I) of this section, the total contract price (or gross contract price) must be reduced to the extent of any amount recognized by the old taxpayer with respect to the contract in connection with the transaction (e.g., any amount recognized under section 351(b) or section 357 that is attributable to the contract and any income recognized by the old taxpayer pursuant to the basis adjustment rule of paragraph (k)(3)(iv)(A) of this section).

(2) Basis in contract. The new taxpayer’s basis in a contract (including the uncompleted property, if applicable) acquired in a transaction described in paragraphs (k)(3)(ii)(A) through (E) or paragraph (k)(3)(iii)(I) of this section will be computed under section 362, section 334, or section 723, as applicable. Upon a new taxpayer’s completion (actual or constructive) of a CCM or a PCM contract acquired in a transaction described in paragraphs (k)(3)(ii)(A) through (E) or paragraph (k)(3)(iii)(I) of this section, the new taxpayer’s basis in the contract (including the uncompleted property, if applicable) is reduced to zero. The new taxpayer is not entitled to a deduction or loss in connection with any basis reduction pursuant to this paragraph (k)(3)(iv)(B)(2).

(C) Definition of old taxpayer and new taxpayer for certain partnership transactions. For purposes of paragraphs (k)(3)(ii), (iii) and (iv) of this section, in the case of a transaction described in paragraph (k)(3)(i)(I) of this section, the partner contributing the contract to the partnership is treated as the old taxpayer, and the partnership receiving the contract from the partner is treated as the new taxpayer.

(D) Exceptions to step-in-the-shoes rules for S corporations. Upon a transfer described in paragraph (k)(3)(ii)(F) of this section or a conversion described in paragraph (k)(3)(ii)(G) of this section, paragraphs (k)(3)(ii) and (iii) of this section apply to a contract accounted for under a long-term contract method of accounting only if the S corporation’s books are closed under section 1362(e)(3), section 1362(e)(6)(C), section 1362(e)(6)(D), section 1377(a)(2), or §1.1502–76 on the date of the transfer or conversion. In these cases, the corporation is treated as both the old taxpayer and the new taxpayer for purposes of paragraphs (k)(3)(ii) and (iii) of this section. In all other cases involving these transfers, the corporation shall compute its income or loss from each contract accounted for under a long-term contract method of accounting for the period that includes the date of the transaction as though no change in taxpayer had occurred with respect to the contract, and must allocate the income or loss from the contract for that period in accordance with the rules generally applicable to transfers of S corporation stock and conversions to or from S corporation status. This paragraph (k)(3)(iv)(D) is applicable for transactions on or after July 16, 2004. In addition, this paragraph (k)(3)(iv)(D) may be relied upon for transactions on or after May 15, 2002.

(v) Special rules relating to certain partnership transactions — (A) Section 704(c) — (1) Contributions of contracts. The principles of section 704(c)(1)(A), section 737, and the regulations thereunder apply to income or loss with respect to a contract accounted for under a long-term contract method of accounting that is contributed to a partnership. The amount of built-in income or built-in loss attributable to a contributed contract that is subject to section 704(c)(1)(A) is determined as follows. First, the contributing partner must take into account any income or loss required under paragraph (k)(3)(ii)(A) of this section for the period ending on the date of the contribution. Second, the partnership must determine the amount of income or loss that the contributing partner would take into account if the contract were disposed of for its fair market value in a constructive completion transaction. This calculation is treated as occurring immediately after the partner has applied paragraph (k)(3)(ii)(A) of this section, but before the contribution to the partnership. Finally, this amount is reduced by the amount of income, if any, that the contributing partner is required to recognize as a result of the contribution.

(B) Basis adjustments under sections 743(b) and 734(b). For purposes of §§1.743–1(d), 1.755–1(b), and 1.755–1(c), the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting is the amount of income or loss that the partnership would take into account under the constructive completion rules of paragraph (k)(2) of this section if, at the time of the sale of a partnership interest or the distribution to a partner, the partnership disposed of the contract for its fair market value in a constructive completion transaction. If all or part of the transferee’s basis adjustment under section 743(b) or the partnership’s basis adjustment under section 734(b) is allocated to a contract accounted for under a long-term contract method of accounting, the basis adjustment shall reduce or
increase, as the case may be, the affected party’s income or loss from the contract. In the case of a contract accounted for under the CCM, the basis adjustment is taken into account in the year in which the contract is completed. In the case of a contract accounted for under a long-term contract method of accounting other than the CCM, the portion of that basis adjustment that is recovered in each taxable year of the partnership must be determined by the partnership in a manner that reasonably accounts for the adjustment over the remaining term of the contract.

(C) Cross reference. See paragraph (k)(2)(iv)(E) of this section for rules relating to the application of section 751 to the transfer of an interest in a partnership holding a contract accounted for under a long-term contract method of accounting.

(D) Exceptions to step-in-the-shoes rules. Upon a contribution described in a paragraph (k)(3)(i)(J) of this section, a transfer described in paragraph (k)(3)(i)(K) of this section, or a distribution described in paragraph (k)(3)(i)(L) of this section, paragraphs (k)(3)(ii) and (iii) of this section apply to a contract accounted for under a long-term contract method of accounting only if the partnership’s books are properly closed with respect to that contract under section 706. In these cases, the partnership is treated as both the old taxpayer and the new taxpayer for purposes of paragraphs (k)(3)(ii) and (iii) of this section. In all other cases involving these transactions, the partnership shall compute its income or loss from each contract accounted for under a long-term contract method of accounting for the period that includes the date of the transaction as though no change in taxpayer had occurred with respect to the contract, and must allocate the income or loss from the contract for that period under a reasonable method complying with section 706.

* * * * *

(5) * * *

Example 9. Constructive completion — PCM — distribution of contract by partnership — (i) Facts. In Year 1, W, X, Y, and Z each contribute $100,000 to form equal partnership PRS. In Year 1, PRS incurs costs of $600,000 and the estimated total allocable contract costs are $800,000. In Year 1, PRS incurs costs of $600,000 and receives $650,000 in progress payments under the contract. Under the contract, PRS performed all of the services required in order to be entitled to receive the progress payments, and there was no obligation to return the payments or perform any additional services in order to retain the payments. PRS properly accounts for the contract under the PCM. In Year 2, PRS distributes the contract to X in liquidation of X’s interest. PRS incurs no costs and receives no progress payments in Year 2 prior to the distribution. At the time of the distribution, PRS’s only asset other than the long-term contract and the partially constructed property is $450,000 cash ($400,000 initially contributed and $50,000 in excess progress payments). The fair market value of the contract is $150,000. Pursuant to the distribution, X assumes PRS’s contract obligations and rights. In Year 2, X incurs additional allocable contract costs of $50,000. X correctly estimates at the end of Year 2 that X will have to incur an additional $75,000 of allocable contract costs in Year 3 to complete the contract (rather than $150,000 as originally estimated by PRS). Assume that X properly accounts for the contract under the PCM, that PRS has no income or loss other than income or loss from the contract, and that PRS has an election under section 754 in effect in Year 2.

(ii) Tax consequences to PRS. For Year 1, PRS reports receipts of $750,000 (the completion factor multiplied by total contract price ($600,000/$800,000 x $1,000,000)) and costs of $600,000, for a profit of $150,000, which is allocated equally among W, X, Y, and Z ($37,500 each). Immediately prior to the distribution of the contract to X in Year 2, the contract is deemed completed. Under paragraph (k)(2)(iv)(B) of this section, the fair market value of the contract ($150,000) is treated as the amount realized from the transaction. For purposes of applying the PCM in Year 2, the total contract price is $800,000 (the sum of the amounts received under the contract and the amount treated as realized from the transaction ($650,000 + $150,000)) and the total allocable contract costs are $600,000. Thus, in Year 2 PRS reports receipts of $50,000 (total contract price minus receipts already reported ($800,000 - $750,000)), and costs incurred in Year 2 of $0, for a profit of $50,000. Under paragraph (k)(2)(iv)(B) of this section, this profit must be allocated among W, X, Y, and Z as though the partnership closed its books on the date of the distribution. Accordingly, each partner’s distributive share of this income is $12,500.

(iii) Tax consequences to X. X’s basis in its interest in PRS immediately prior to the distribution is $150,000 ($100,000 initial contribution, increased by $50,000, X’s distributive share of Year 2 income). Under paragraph (k)(2)(iv)(D) of this section, PRS’s basis in the contract (including the uncompleted property, if applicable) immediately prior to the distribution is equal to $150,000 (the partnership’s allocable contract costs, $600,000, increased by the amount of cumulative taxable income recognized by PRS on the contract through the date of the distribution (including amounts recognized as a result of the constructive completion), $200,000, decreased by the amounts that the partnership has received or reasonably expects to receive under the contract, $650,000). Under section 732, X’s basis in the contract (including the uncompleted property) after the distribution is $150,000. Under paragraph (k)(2)(iv)(C) of this section, X’s basis in the contract (including the uncompleted property) is treated as consideration paid by X that is allocable to the contract. X’s total contract price is $200,000 (the amount remaining to be paid under the terms of the contract less the consideration allocable to the contract ($350,000 - $150,000)). For Year 2, X reports receipts of $80,000 (the completion factor multiplied by the total contract price ($150,000/$125,000 x $200,000)) and costs of $50,000 (the costs incurred after the distribution of the contract), for a profit of $30,000. For Year 3, X reports receipts of $120,000 (the total contract price minus receipts already reported ($200,000 - $80,000)) and costs of $75,000, for a profit of $45,000.
(iv) Section 734(b). The results under section 734(b) are the same as in Example 9.

Example 11. Step-in-the-shoes — PCM — contribution of contract to partnership — (i) Facts. In Year 1, X enters into a contract that X properly accounts for under the PCM. The total contract price is $1,000,000 and the estimated total allocable contract costs are $800,000. In Year 1, X incurs costs of $600,000 and receives $650,000 in progress payments under the contract. Under the contract, X performed all of the services required in order to be entitled to receive the progress payments, and there was no obligation to return the payments or perform any additional services in order to retain the payments. In Year 2, X contributes the contract (including the uncompleted property) with a basis of $0 and $125,000 of cash to partnership PRS in exchange for a one-fourth partnership interest. X incurs costs of $10,000, and receives no progress payments in Year 2 prior to the contribution of the contract. X and the other three partners of PRS share equally in its capital, profits, and losses. The parties determine that, at the time of the contribution, the fair market value of the contract is $160,000. Following the contribution in Year 2, PRS incurs additional allocable contract costs of $40,000. PRS correctly estimates at the end of Year 2 that it will have to incur an additional $75,000 of allocable contract costs in Year 3 to complete the contract (rather than $150,000 as originally estimated by PRS).

(ii) Tax consequences to X. For Year 1, X reports receipts of $750,000 (the completion factor multiplied by the total contract price ($600,000/$800,000 x $1,000,000)) and costs of $600,000, for a profit of $150,000. Because the mid-contract change in taxpayer results from a transaction described in paragraph (k)(3)(i)(I) of this section, X is not treated as completing the contract in Year 2. Under paragraph (k)(3)(ii)(A) of this section, for Year 2, X reports receipts of $12,500 (the completion factor multiplied by the total contract price ($610,000/$800,000 x $1,000,000, or $762,500), decreased by receipts already reported, $750,000) and costs of $10,000, for a profit of $2,500. Under section 722, X’s initial basis in its interest in PRS is $125,000. Pursuant to paragraph (k)(3)(iv)(A)(I) of this section, X must increase its basis in its interest in PRS by the amount of gross receipts X recognized under the contract, $762,500, and reduce its basis by the amount of gross receipts X received under the contract, the $650,000 in progress payments. Accordingly, X’s basis in its interest in PRS is $237,500.

(iii) Tax consequences to PRS. Because the mid-contract change in taxpayer results from a step-in-the-shoes transaction, PRS must account for the contract using the same methods of accounting used by X prior to the transaction. The total contract price is the sum of any amounts that X and PRS have received or reasonably expect to receive under the contract, and total allocable contract costs are the allocable contract costs of X and PRS. For Year 2, PRS reports receipts of $134,052 (the completion factor multiplied by the total contract price [$650,000/$725,000 x $1,000,000], $896,552, decreased by receipts reported by X, $762,500) and costs of $40,000, for a profit of $94,052. For Year 3, PRS reports receipts of $103,448 (the total contract price minus prior year receipts ($1,000,000 - $896,552)) and costs of $75,000, for a profit of $28,448.

(iv) Section 704(c). The principles of section 704(c) and $1,704-3 apply to allocations of income or loss with respect to the contract contributed by X. In this case, the amount of built-in income that is subject to section 704(c) is the amount of income or loss that the contributing partner would take into account if the contract were disposed of for its fair market value in a constructive completion transaction. This calculation is treated as occurring immediately after the partner has applied paragraph (k)(3)(ii)(A) of this section, but before the contribution to the partnership. In a constructive completion transaction, the total contract price would be $810,000 (the sum of the amounts received under the contract and the amount realized in the deemed sale ($650,000 + $160,000)) and its total allocable contract costs of $610,000, for a profit of $200,000. Thus, the amount of built-in income that is subject to section 704(c) is $200,000. Out of PRS’s income of $275,000, in Year 3, $200,000 must be allocated to X under section 704(c), and the remaining $75,000 is allocated equally among all of the partners.

Example 13. Step-in-the-shoes — PCM — transfer of a partnership interest — (i) Facts. In Year 1, W, X, Y, and Z each contribute $100,000 to form equal partnership PRS. In Year 1, PRS enters into a contract. The total contract price is $1,000,000 and the estimated total allocable contract costs are $800,000. In Year 1, PRS incurs costs of $600,000 and receives $650,000 in progress payments under the contract. Under the contract, PRS performed all of the services required in order to be entitled to receive the progress payments, and there was no obligation to return the payments or perform any additional services in order to retain the payments. PRS properly accounts for the contract under the PCM. In Year 2, W transfers his interest in PRS to T for $150,000. Assume that $10,000 of PRS’s Year 2 costs are incurred prior to the transfer, $40,000 are incurred after the transfer; and that PRS receives no progress payments in Year 2. Also assume that the fair market value of the contract on the date of the transfer is $160,000, that PRS closes its books with respect to the contract under section 706 on the date of the transfer, and that PRS correctly estimates at the end of Year 2 that it will have to incur an additional $75,000 of allocable contract costs in Year 3 to complete the contract (rather than $150,000 as originally estimated by PRS).

Example 14. Step-in-the-shoes — CCM — contribution of contract to partnership — (i) Facts. The facts are the same as in Example 11, except that X and PRS properly account for the contract under the CCM. In Year 1, X and PRS have a basis of $125,000 in the contract (including the uncompleted property).

(ii) Tax consequences to X. X reports no income or costs from the contract in Years 1 or 2. X is not treated as completing the contract in Year 2. Under section 722, X’s initial basis in its interest in PRS is $125,000. Pursuant to paragraph (k)(3)(iv)(A)(I) of this section, X must increase its basis in its interest in PRS by the amount of gross receipts X recognized under the contract, $762,500, and reduce its basis by the amount of gross receipts X received under the contract, the $650,000 in progress payments. Accordingly, X’s basis in its interest in PRS is $237,500.

(iii) Tax consequences to PRS. Because the mid-contract change in taxpayer results from a step-in-the-shoes transaction, PRS must account for the contract using the same methods of accounting used by X prior to the transaction. The total contract price is the sum of any amounts that X and PRS have received or reasonably expect to receive under the contract, and total allocable contract costs are the allocable contract costs of X and PRS. For Year 2, PRS reports receipts of $134,052 (the completion factor multiplied by the total contract price [$650,000/$725,000 x $1,000,000]) and costs of $40,000, for a profit of $94,052. This profit is shared equally among W, X, Y, and Z ($37,500 each). Under paragraph (k)(3)(ii)(A) of this section, for the part of Year 2 ending on the date of the transfer of W’s interest, PRS reports receipts of $12,500 (the completion factor multiplied by the total contract price ($610,000/$800,000 x $1,000,000)) and costs of $600,000, for a profit of $150,000. This profit is allocated equally among W, X, Y, and Z ($37,500 each).

(iii) Income reporting for period ending on date of transfer. For Year 1, PRS reports receipts of $750,000 (the completion factor multiplied by total contract price ($600,000/$800,000 x $1,000,000)) and costs of $600,000, for a profit of $150,000. This profit is allocated equally among W, X, Y, and Z ($625,000 each). Under paragraph (k)(3)(ii)(A) of this section, for the part of Year 2 beginning on the day after the transfer, PRS reports receipts of $134,052 (the completion factor multiplied by the total contract price decreased by receipts reported by PRS for the period ending on the date of the transfer ($650,000/$725,000 x $1,000,000) - $762,500) and costs of $40,000, for a profit of $94,052. This profit is shared equally among T, X, Y, and Z ($23,513 each). For Year 3, PRS reports receipts of $103,448 (the total contract price minus prior year receipts ($1,000,000 - $986,552)) and costs of $75,000, for a profit of $28,448. The
profit for Year 3 is shared equally among T, X, Y, and Z ($7,112 each).

(iv) Tax consequences to W. W’s amount realized is $150,000. W’s adjusted basis in its interest in PRS is $138,125 ($100,000 originally contributed, plus $37,500, W’s distributive share of PRS’s Year 1 income, and $625, W’s distributive share of PRS’s Year 2 income prior to the transfer). Accordingly, W’s income from the sale of W’s interest in PRS is $11,875. Under paragraph (k)(2)(iv)(E) of this section, for purposes of section 751(a), the amount of ordinary income attributable to the contract is determined as follows. First, the partnership must determine the amount of income or loss from the contract that is allocated under section 706 to the period ending on the date of the sale ($625). Second, the partnership must determine the amount of income or loss that the partnership would take into account under the constructive completion rules of paragraph (k)(2) of this section if the contract were disposed of for its fair market value in a constructive completion transaction. Because PRS closed its books under section 706 with respect to the contract on the date of the sale, this calculation is treated as occurring immediately after the partnership has applied paragraph (k)(3)(ii)(A) of this section on the date of the sale. In a constructive completion transaction, the total contract price would be $810,000 (the sum of the amounts received under the contract and the amount realized in the deemed sale ($650,000 + $160,000)). PRS would report receipts of $47,500 (total contract price minus receipts already reported ($810,000 - $762,500)) and costs of $0, for a profit of $47,500. Thus, the amount of ordinary income attributable to the contract is $47,500, and W’s share of that income is $11,875. Thus, under §1.751–1(a), all of W’s $11,875 of income from the sale of W’s interest in PRS is ordinary income.

(v) Tax consequences to T. T’s adjusted basis for its interest in PRS is $150,000. Under §1.743–1(d)(2), the amount of income that would be allocated to T if the contract were disposed of for its fair market value (adjusted to account for income from the contract for the portion of PRS’s taxable year that ends on the date of the transfer) is $11,875. Under §1.743–1(b), the amount of T’s basis adjustment under section 743(b) is $11,875. Under paragraph (k)(3)(v)(B) of this section, the portion of T’s basis adjustment that is recovered in Year 2 and Year 3 must be determined by PRS in a manner that reasonably accounts for the adjustment over the remaining term of the contract. For example, PRS could recover $6,703 of the adjustment in Year 2 (the amount of the basis adjustment, $11,875, multiplied by a fraction, the numerator of which is the excess of the completion factor for the year, $650,000/$725,000, less the completion factor for the prior year, $610,000/$800,000, and the denominator of which is 100 percent reduced by the completion factor for the taxable year preceding the transfer, $610,000/$800,000). T’s distributive share of income in Year 2 from the contract would be adjusted from $23,513 to $16,810 as a result of the basis adjustment. In Year 3, the completion year, PRS could recover $5,172 of the adjustment ($11,875 x ($725,000/$725,000 - $650,000/$725,000) / 100 percent - ($610,000/$800,000))). T’s distributive share of income in Year 3, the completion year, from the contract would be adjusted from $7,112 to $1,940 as a result of the basis adjustment.

* * * * *

(6) Effective date. Except as provided in paragraph (k)(3)(iv)(D) of this section, this paragraph (k) is applicable for transactions on or after May 15, 2002. * * * * *

Par. 4. Section 1.460–6 is amended by revising paragraphs (g)(3)(ii)(D) and (g)(4) to read as follows:

§1.460–6 Look-back method.

* * * * * 

(g) * * *

(3) * * *

(ii) * * *

(D) Information old taxpayer must provide — (1) In general. Except as provided in paragraph (g)(3)(ii)(D) of this section, in order to help the new taxpayer to apply the look-back method with respect to pre-transaction taxable years, any old taxpayer that accounted for income from a long-term contract under the PCM or PCCM for either regular or alternative minimum tax purposes is required to provide the information described in this paragraph to the new taxpayer by the due date (not including extensions) of the old taxpayer’s income tax return for the first taxable year ending on or after a step-in-the-shoes transaction described in §1.460–4(k)(3)(i). The required information is as follows -- 

(i) The portion of the contract reported by the old taxpayer under PCM for regular and alternative minimum tax purposes (i.e., whether the old taxpayer used PCM, the 40/60 PCCM method, or the 70/30 PCCM method); 

(ii) Any submethods used in the application of PCM (e.g., the simplified cost-to-cost method or the 10-percent method); 

(iii) The amount of total contract price reported by year; 

(iv) The numerator and the denominator of the completion factor by year; 

(v) The due date (not including extensions) of the old taxpayer’s income tax return for each taxable year in which income was required to be reported; 

(vi) Whether the old taxpayer was a corporate or a noncorporate taxpayer by year; and 

(vii) Any other information required by the Commissioner by administrative pronouncement.

(2) Special rules for certain pass-through entity transactions. For purposes of paragraph (g)(3)(ii)(D) of this section, in the case of a transaction described in §1.460–4(k)(3)(i)(I), the contributing partner is treated as the old taxpayer, and the partnership is treated as the new taxpayer. In the case of transactions described in §1.460–4(k)(3)(ii)(F), (G), (J), (K), or (L), the old taxpayer is not required to provide the information described in paragraph (g)(3)(ii)(D) of this section, because information necessary for the new taxpayer to apply the look-back method is provided by the pass-through entity. This paragraph (g)(3)(ii)(D) is applicable for transactions on or after August 6, 2003.

* * * * *

(4) Effective date. Except as provided in paragraph (g)(3)(ii)(D) of this section, this paragraph (g) is applicable for transactions on or after May 15, 2002.

* * * * *

Par. 5. In §1.704–3, a sentence is added at the end of paragraph (a)(3)(ii) to read as follows:

§1.704–3 Contributed property.

(a) * * *

(3) * * *

(ii) * * * See §1.460–4(k)(3)(v)(A) for a rule relating to the amount of built-in income or built-in loss attributable to a contract accounted for under a long-term contract method of accounting.

* * * * *

Par. 6. Section 1.722–1 is amended by adding a sentence between the sixth and seventh sentences to read as follows:

§1.722–1 Basis of contributing partner’s interest.

* * * See §1.460–4(k)(3)(iv)(A) for rules relating to basis adjustments required where a contract accounted for under a long-term contract method of accounting is transferred in a contribution to which section 721(a) applies.

* * * * *

Par. 7. A sentence is added at the end of §1.723–1 to read as follows:

§1.723–1 Basis of property contributed to partnership.

* * * See §1.460–4(k)(3)(iv)(B)(2) for rules relating to adjustments to the basis of
contracts accounted for using a long-term contract method of accounting that are acquired in certain contributions to which section 721(a) applies.

Par. 8. In §1.732–1, a sentence is added at the end of paragraph (c)(1)(i) to read as follows:

§1.732–1 Basis of distributed property other than money.

* * * * *
(c) * * *
(1) * * *
(ii) * * *

(i) ** See §1.460–4(k)(2)(iv)(D) for a rule determining the partnership’s basis in a long-term contract accounted for under a long-term contract method of accounting.

* * * * *

Par. 9. In §1.734–1, the undesignated paragraph immediately following paragraph (b)(1)(ii) is revised to read as follows:

§1.734–1 Optional adjustment to basis of undistributed partnership property.

* * * * *
(b) * * *
(1) * * *
(ii) * * *
See §1.460–4(k)(2)(iv)(D) for a rule determining the partnership’s basis in a long-term contract accounted for under a long-term contract method of accounting. The provisions of this paragraph (b)(1) are illustrated by the following examples:

* * * * *

Par. 10. Section 1.743–1 is amended as follows:

1. A sentence is added at the end of paragraph (d)(2).
2. A sentence is added at the end of paragraph (j)(2).

The additions read as follows:

§1.743–1 Optional adjustment to basis of partnership property.

* * * * *
(d) * * *
(2) * * * See §1.460–4(k)(3)(v)(B) for a rule relating to the computation of income or loss that would be allocated to the transferee from a contract accounted for under a long-term contract method of accounting as a result of the hypothetical transaction.

* * * * *

§1.755–1 Rules for allocation of basis.

* * * * *
(b) * * *
(1) * * *
(ii) **See §1.460–4(k)(3)(v)(B) for a rule relating to the computation of income or loss that would be allocated to the transferee from a contract accounted for under a long-term contract method of accounting.

* * * * *

Par. 11. In §1.751–1, a sentence is added at the end of paragraph (a)(2) to read as follows:

§1.751–1 Unrealized receivables and inventory items.

(a) * * *
(2) * * * See §1.460–4(k)(2)(iv)(E) for rules relating to the amount of ordinary income or loss attributable to a contract accounted for under a long-term contract method of accounting.

* * * * *

Par. 12. Section 1.755–1 is amended as follows:

1. Adding a sentence at the end of paragraph (b)(1)(ii).
2. Paragraph (c)(5) is redesignated as paragraph (c)(6).
3. New paragraph (c)(5) is added.

The additions read as follows:

§1.755–1 Rules for allocation of basis.

* * * * *
(b) * * *
(1) * * *
(ii) See §1.460–4(k)(3)(v)(B) for a rule relating to the computation of income or loss that would be allocated to the transferee from a contract accounted for under a long-term contract method of accounting as a result of the hypothetical transaction.

* * * * *

§1.1362–3 Treatment of S termination year.

(a) ** * See §1.460–4(k)(3)(iv)(D) for rules relating to the computation of the corporation’s income or loss from a contract accounted for under a long-term contract method of accounting in determining the transferee’s distributive share of income or loss from the contract.

* * * * *

Par. 14. Section 1.1377–1 is amended by adding a sentence at the end of paragraph (a)(1) to read as follows:

§1.1377–1 Pro Rata Share.

(a) * * *
(1) ** See §1.460–4(k)(3)(iv)(D) for rules relating to the computation of the shareholders’ pro rata share of the corporation’s income or loss from a contract accounted for under a long-term contract method of accounting.

* * * * *

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

Approved July 1, 2004.

Gregory Jenner,
Assistant Secretary of the Treasury.

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Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.


Rev. Rul. 2004–90

The Internal Revenue Service is continuing its program of reviewing rulings (including revenue rulings, revenue procedures and notices) published in the Internal Revenue Bulletin to identify those rulings that, although not specifically revoked
or superseded, are no longer considered determinative because: (1) the applicable statutory provisions or regulations have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or subsequent published position; or (3) the facts set forth no longer exist or are not sufficiently described to permit clear application of the current statute and regulations.

This revenue ruling publishes a list of rulings that have been identified under the Service’s review program as no longer being determinative. The rulings are categorized by the Assistant Chief Counsel offices in the Office of Associate Chief Counsel (Procedure and Administration) that have primary jurisdiction over the subject matter of the rulings that have been identified as no longer being determinative.

Accordingly, the rulings listed below are hereby declared obsolete.

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**Assistant Chief Counsel (Administrative Provisions and Judicial Practice)**

<table>
<thead>
<tr>
<th>Ruling No.</th>
<th>C.B. Citation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rev. Proc. 89-37¹</td>
<td>1989-1 C.B. 919</td>
</tr>
<tr>
<td>Rev. Proc. 96-18</td>
<td>1996-1 C.B. 637</td>
</tr>
</tbody>
</table>

**Assistant Chief Counsel (Disclosure and Privacy Law)**

<table>
<thead>
<tr>
<th>Ruling No.</th>
<th>Citation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rev. Rul. 58-120</td>
<td>1958-1 C.B. 498</td>
</tr>
<tr>
<td>Rev. Rul. 70-58²</td>
<td>1970-1 C.B. 268</td>
</tr>
<tr>
<td>Rev. Rul. 79-64</td>
<td>1979-1 C.B. 390</td>
</tr>
</tbody>
</table>

The Service will continue to review other rulings to ascertain those that, for the reasons stated above, are no longer determinative. Therefore, failure to include a particular ruling in the above list should not be construed as an indication that the ruling is determinative.

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**DRAFTING INFORMATION**

The principal author of this revenue ruling is Sarah Tate of the Office of Associate Chief Counsel, Procedure and Administration (Disclosure & Privacy Law). For further information regarding the rulings obsoleted in this revenue ruling, contact the following persons from the appropriate Assistant Chief Counsel offices (not toll-free calls):

<table>
<thead>
<tr>
<th>Name</th>
<th>Assistant Chief Counsel</th>
<th>Telephone No.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sarah Tate</td>
<td>Disclosure &amp; Privacy Law</td>
<td>202–622–4570</td>
</tr>
</tbody>
</table>

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¹ The procedures described in Rev. Proc. 89-37 for obtaining employer identification numbers (EINs) have been supplanted by the Service’s Online EIN Application (I-EIN) process. EINs also may be obtained through the Service’s Tele-TIN or Fax-TIN programs, or by submitting a Form SS-4 by mail to the appropriate IRS service center. Additional information regarding EINs is available on the Service website at www.irs.gov.

² Subsequent statutory amendments address the issue in the revenue ruling.
III. COMMENTS REQUESTED

The Service and Treasury Department have received questions about whether the final regulations under § 423 should be interpreted consistently with the proposed regulations concerning ISO’s. Additionally, the Service and Treasury have received specific questions including the following:

1. Whether any subcategory of employees may be excluded from participation in an ESPP under § 423(b)(4) of the Code, and if so, under what conditions these employees should be excluded;

2. Whether additional rules concerning the inadvertent exclusion of employees should be included in the regulations, and if so, whether and how the excluded employees should be allowed to participate in past offerings under the plan;

3. Whether the calculation of the amount of stock that may be purchased under an ESPP (the $25,000 limit under § 423(b)(8)) should be determined in a manner consistent with the $100,000 limitation for ISO’s described in the §1.422-4;

4. Whether the participation rules in § 423(b)(4) and the equal rights and privileges rules in § 423(b)(5) should include additional rules for new employees or new participants (for example, if an employee is hired on the last day of the purchase period, whether the purchase period should be extended only for this individual);

5. Whether shareholder approval is required to add highly-compensated individuals to a plan under § 423(b)(2) and § 1.423–2(c)(3);

6. Whether individuals should be allowed to carryover amounts from an earlier plan or offering to a new plan or offering without violating the equal rights and privileges provision in § 423(b)(5);

7. Whether the regulations should include limitations on the increase or decrease of contribution amounts under an ESPP; and

8. Whether special rules concerning the exclusion and equal rights and privileges should be included in the regulations for foreign employees.

The Service and Treasury Department encourage comment on these issues and on any other issues that should be addressed or clarified in revising the final regulations under § 423.

Comments should be submitted by October 1, 2004, to CC:PA:LPD:PR (Notice 2004–55), Room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, D.C. 20044. Comments may be hand delivered between the hours of 8 a.m. and 4 p.m., Monday through Friday to CC:PA:LPD:PR (Notice 2004–55), Courier’s Desk, Internal Revenue Service, 1111 Constitution Ave., NW, Washington, D.C. Alternatively, comments may be submitted via the Internet at Notice.Comments@irs.counsel.treas.gov. All comments will be available for public inspection.

IV. DRAFTING INFORMATION

The principal author of this notice is Erin Madden of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). However, other personnel from the IRS and Treasury Department participated in its development. For further information regarding this notice, please contact Erin Madden at (202) 622–6030 (not a toll-free call).

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, § 42; 1.42–14.)

Rev. Proc. 2004–52

SECTION 1. PURPOSE

This revenue procedure publishes the amounts of unused housing credit carry-

SECTION 2. BACKGROUND

Rev. Proc. 92–31, 1992–1 C.B. 775, provides guidance to state housing credit agencies of qualified states on the procedure for requesting an allocation of unused housing credit carryovers under § 42(h)(3)(D). Section 4.06 of Rev. Proc. 92–31 provides that the Internal Revenue Service will publish in the Internal Revenue Bulletin the amount of unused housing credit carryovers allocated to qualified states for a calendar year from a national pool of unused credit authority (the National Pool). This revenue procedure publishes these amounts for calendar year 2004.

SECTION 3. PROCEDURE

The unused housing credit carryover amount allocated from the National Pool by the Secretary to each qualified state for calendar year 2004 is as follows:

<table>
<thead>
<tr>
<th>Qualified State</th>
<th>Amount Allocated</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>$ 116,460</td>
</tr>
<tr>
<td>Arizona</td>
<td>144,407</td>
</tr>
<tr>
<td>California</td>
<td>918,183</td>
</tr>
<tr>
<td>Florida</td>
<td>440,379</td>
</tr>
<tr>
<td>Georgia</td>
<td>224,723</td>
</tr>
<tr>
<td>Idaho</td>
<td>35,355</td>
</tr>
<tr>
<td>Illinois</td>
<td>327,419</td>
</tr>
<tr>
<td>Indiana</td>
<td>160,316</td>
</tr>
<tr>
<td>Kansas</td>
<td>70,473</td>
</tr>
<tr>
<td>Kentucky</td>
<td>106,551</td>
</tr>
<tr>
<td>Maine</td>
<td>33,787</td>
</tr>
<tr>
<td>Maryland</td>
<td>142,547</td>
</tr>
<tr>
<td>Massachusetts</td>
<td>166,469</td>
</tr>
<tr>
<td>Minnesota</td>
<td>130,915</td>
</tr>
<tr>
<td>Mississippi</td>
<td>74,555</td>
</tr>
<tr>
<td>Missouri</td>
<td>147,607</td>
</tr>
<tr>
<td>Nebraska</td>
<td>45,005</td>
</tr>
<tr>
<td>New Hampshire</td>
<td>33,320</td>
</tr>
<tr>
<td>New Jersey</td>
<td>223,524</td>
</tr>
<tr>
<td>New York</td>
<td>496,557</td>
</tr>
<tr>
<td>North Carolina</td>
<td>217,543</td>
</tr>
<tr>
<td>Ohio</td>
<td>295,909</td>
</tr>
<tr>
<td>Oregon</td>
<td>92,107</td>
</tr>
<tr>
<td>South Carolina</td>
<td>107,310</td>
</tr>
<tr>
<td>Tennessee</td>
<td>151,159</td>
</tr>
<tr>
<td>Texas</td>
<td>572,331</td>
</tr>
<tr>
<td>Utah</td>
<td>60,846</td>
</tr>
<tr>
<td>Vermont</td>
<td>16,020</td>
</tr>
<tr>
<td>Virginia</td>
<td>191,126</td>
</tr>
<tr>
<td>Washington</td>
<td>158,655</td>
</tr>
<tr>
<td>West Virginia</td>
<td>46,844</td>
</tr>
<tr>
<td>Wisconsin</td>
<td>141,599</td>
</tr>
</tbody>
</table>

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for allocations of housing credit dollar amounts attributable to the National Pool component of a qualified state’s housing credit ceiling for calendar year 2004.

DRAFTING INFORMATION

The principal author of this revenue procedure is Christopher J. Wilson of the Office of Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue procedure, contact Mr. Wilson at (808) 539–2874 or Susan Reaman at (202) 622–3040 (not toll-free calls).

26 CFR 601.602: Forms and instructions. (Also Part I, §§ 6011, 6051, 6071; 31.6011(a)–4, 31.6051–1, 31.6071(a)–1.)

Rev. Proc. 2004–53

SECTION 1. PURPOSE

.01 This revenue procedure supersedes Rev. Proc. 96–60, 1996–2 C.B. 399. This revenue procedure explains both
the standard procedure and an alternate procedure for preparing and filing Form W–2. The Code provides that any person required to make a quarterly return of income tax withheld from wages.

Section 3. BACKGROUND

.01 Section 6011(a)–4 prescribes Form 941 as the form to use for persons required to make a quarterly return of income tax withheld from wages.

.04 Section 31.6011(a)–6 provides that an employer who ceases to pay wages reportable on Form 941 shall file a final Form 941.

.05 Section 31.6071(a)–1 provides that the Form 941 generally must be filed on or before the last day of the first calendar month following the period for which it is made.

.06 Section 6051(a) provides that (1) every person required to deduct and withhold FICA or income tax, or who would have been required to deduct and withhold income tax if the employee had claimed no more than 1 withholding exemption, or (2) every employer engaged in a trade or business who pays remuneration for services performed by an employee, must furnish a written statement to an employee regarding the remuneration paid to the employee during the calendar year. Section 31.6051–1(a) provides that the statement is Form W–2.

.07 Section 31.6051–1(d)(1)(i) provides that Form W–2 must be furnished to the employee on or before January 31 of the following calendar year. If the employee’s employment is terminated before the close of the calendar year, however, and the employee requests the employer to furnish the Form W–2 at an earlier time, the Form W–2 must be furnished to the employee on or before the later of the 30th day after the written request from the employee or the 30th day after the day on which the last payment of wages is made.

.08 Section 31.6051–1(d)(1)(ii) provides that an employer who is required to file a final Form 941 must furnish Forms W–2 to its employees on or before the date required for filing the final Form 941. An employer is not permitted to furnish Form W–2 pursuant to the rule in § 31.6051–1(d)(1)(i) relating to written requests by terminated employees for Form W–2, if that would be at a time later than that required under the rule in § 31.6051–1(d)(1)(ii)(B) for an employer who ceases to pay wages.

.09 Section 31.6071(a)–1(a)(3)(i) provides the general rule that a Form W–2 (Copy A) must be filed on or before the last day of February (or March 31 if filed elec-
tronically) of the year following the calendar year for which it is made.

.10 Section 31.6071(a)–1(a)(3)(ii) provides that an employer who is required to file a final Form 941 must file Forms W–2 (Copy A) on or before the last day of the second calendar month following the period for which the final Form 941 is filed.

.11 Section 31.6051–2 provides that Forms W–2 (Copy A) must be filed with the Social Security Administration (SSA).

.12 Section 31.3402(f)(5)–1(c) provides that an employer may establish a system for its employees to submit Form W–5 electronically.

.13 Announcement 99–3, 1999–1 C.B. 324, provides that an employer may establish a system for its employees to submit Form W–5 electronically.

SECTION 4. STANDARD PROCEDURE FOR PREDECESSORS AND SUCCESSORS

.01 In general. Under the standard procedure, the predecessor performs all the reporting duties for the wages and other compensation it pays. These duties include the filing of quarterly Forms 941 and the furnishing and filing of Forms W–2. In connection with the successor’s acquisition of property and hiring of employees from the predecessor, as described in section 1.01, the predecessor may cease to pay any wages required to be reported on Form 941 (for example, the predecessor may go out of business). In that case, the predecessor must file the Form 941 for the quarter of the acquisition as a final Form 941. If the predecessor does not cease to pay any wages required to be reported on Form 941, (for example, the predecessor remains in business) a final Form 941 is not required. Instead, the predecessor would file its quarterly Form 941 for the quarter of the acquisition. The successor, under the standard procedure, performs all the reporting duties for the wages and other compensation it pays.

.02 Forms W–2.

(1) In general. If, under the circumstances described in section 1.01, the predecessor is not required to file a final Form 941, the predecessor and successor both must furnish Forms W–2 to their respective employees on or before January 31 of the following calendar year. However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the Form W–2 must be furnished on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. The predecessor and successor must file Forms W–2 (Copy A) for their respective employees with SSA on or before the last day of February (or March 31 if filed electronically) of the following calendar year.

(2) Expedited Forms W–2. If, under the circumstances described in section 1.01, the predecessor is required to file a final Form 941, the predecessor must furnish Forms W–2 to its former employees on an expedited basis. Forms W–2 must be furnished on or before the date required for filing the final Form 941 (generally one month after the end of the quarter). However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the predecessor must furnish Form W–2 on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. The predecessor must also file forms W–2 (Copy A) with SSA on an expedited basis. The Forms W–2 (Copy A) must be filed on or before the last day of the second calendar month following the period for which the final Form 941 is required to be filed.

.03 Forms W–4. The predecessor must keep on file the Forms W–4 provided by its former employees. The transferred employees must provide the successor with new Forms W–4 as the successor now becomes responsible for deducting and withholding tax from wages paid to the transferred employees.

.04 Forms W–5. The predecessor must also keep on file the Forms W–5 provided by its former employees. The transferred employees must provide the successor with new Forms W–5 for the current year.

SECTION 5. ALTERNATE PROCEDURE FOR PREDECESSORS AND SUCCESSORS

.01 In general. If, in connection with the circumstances described in section 1.01, the predecessor and successor so agree, the predecessor will be relieved from furnishing Forms W–2 to any employees who will be employed in the same calendar year by the successor (acquired employees). In such circumstances the acquired employees presumably will be paid wages by the successor in the same calendar year and the Forms W–2 furnished to the acquired employees by the successor for the year will include wages paid, and taxes withheld, by both the predecessor and the successor. The predecessor will also be relieved from filing Forms W–2 (Copy A) with SSA for the acquired employees. The predecessor’s entire Form W–2 reporting obligations for the acquired employees will be assumed by the successor. The predecessor remains responsible for the Form W–2 reporting obligations for those employees who are not employed by the successor.

.02 Forms W–2.

(1) In general. If, under the circumstances described in section 1.01, the predecessor is not required to file a final Form 941, the predecessor must furnish Forms W–2 on or before January 31 of the following calendar year to employees who are not employed by the successor. However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the predecessor must furnish Form W–2 on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is earlier. The predecessor must also file Forms W–2 (Copy A) with SSA on an expedited basis. The Forms W–2 (Copy A) must be filed on or before the last day of the second calendar month following the period for which the final Form 941 is required to be filed.

The predecessor and successor both must furnish Forms W–2 to their respective employees on or before January 31 of the following calendar year. However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the Form W–2 must be furnished on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. The predecessor and successor must file Forms W–2 (Copy A) for their respective employees with SSA on or before the last day of February (or March 31 if filed electronically) of the following calendar year.

(2) Expedited Forms W–2. If, under the circumstances described in section 1.01, the predecessor is required to file a final Form 941, the predecessor must furnish Forms W–2 to its former employees on an expedited basis. Forms W–2 must be furnished on or before the date required for filing the final Form 941 (generally one month after the end of the quarter). However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the predecessor must furnish Form W–2 on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. The predecessor must also file forms W–2 (Copy A) with SSA on an expedited basis. The Forms W–2 (Copy A) must be filed on or before the last day of the second calendar month following the period for which the final Form 941 is required to be filed.

.03 Forms W–4. The predecessor must keep on file the Forms W–4 provided by its former employees. The transferred employees must provide the successor with new Forms W–4 as the successor now becomes responsible for deducting and withholding tax from wages paid to the transferred employees.

.04 Forms W–5. The predecessor must also keep on file the Forms W–5 provided by its former employees. The transferred employees must provide the successor with new Forms W–5 for the current year.
ever, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the successor must furnish Form W–2 on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. Forms W–2 (Copy A) must be filed by the successor with SSA on or before the last day of February (or March 31 if filed electronically) of the following calendar year.

(2) Expedited Forms W–2. If, under the circumstances described in section 1.01, the predecessor is required to file a final Form 941, the predecessor must furnish Forms W–2 to the employees who are not employed by the successor on an expedited basis. Forms W–2 must be furnished on or before the date required for filing the final Form 941 (generally one month after the end of the quarter). However, if an employee, whose employment is terminated before the close of the calendar year, requests the Form W–2 earlier, the predecessor must furnish the Form W–2 on or before the 30th day after the written request or the 30th day after the final payment of wages to the employee, whichever is later. Forms W–2 (Copy A) filed with SSA by the predecessor must also be filed on an expedited basis. Forms W–2 (Copy A) must be filed on or before the last day of the second calendar month following the period for which the final Form 941 is required to be filed. The successor is not required to either furnish Forms W–2 to the acquired employees or to file the Forms W–2 (Copy A) with SSA on an expedited basis.

.03 Form 941 filed by predecessor. To the extent the wages paid and the taxes withheld by the predecessor are to be included on the Forms W–2 (Copy A) filed by the successor for the acquired employees, there will be a difference between the amounts shown on the successor’s Forms W–2 (Copy A) and its Forms 941. When the successor files its Form 941, it should also file Schedule D (Form 941) with the predecessor’s final Form 941 which would also be the Form 941 for the third quarter of 2006. If Form 941 is filed electronically, an employer will be able to file Schedule D (Form 941) separately on paper, until the electronic specifications for Schedule D (Form 941) become available.

.04 Form 941 filed by successor. To the extent the wages paid and the taxes withheld by the predecessor are to be included on the Forms W–2 (Copy A) filed by the successor, there will be a difference between the amounts shown on the successor’s Forms W–2 (Copy A) and its Forms 941. Schedule D (Form 941) should include the date of the acquisition and the name, trade name, address, telephone number, and employer identification number of the successor. Schedule D (Form 941) should be filed after Forms W–2 (Copy A) are prepared. Thus, Schedule D (Form 941) should be filed with the first quarter return for the year after the calendar year of the acquisition, or with the final Form 941 if the predecessor is filing a final Form 941 and it is due before the first quarter return for the year after the calendar year of the acquisition. If Form 941 is filed electronically, an employer will be able to file Schedule D (Form 941) separately on paper, until the electronic specifications for Schedule D (Form 941) become available. For instructions relating to the annual wage limitation, see § 31.3121(a)(1)–1.

.05 Forms W–4. The predecessor must file to the successor all current Forms W–4 that were provided to the predecessor by the acquired employees and any written notices received from the Service under § 31.3402(f)(2)–1(g)(5). The successor must keep the transferred Forms W–4 on file. Generally, the successor employer must deduct and withhold from the wages it pays to the acquired employees according to the information supplied on the transferred Forms W–4 until an employee submits a revised form. The successor employer must submit to the Service, in accordance with § 31.3402(f)(2)–1(g), copies of the Forms W–4 received by the predecessor during the current calendar quarter and the preceding calendar quarter. The successor employer must comply with all other requirements under § 31.3402(f)(2)–1(g). For example, the successor employer must withhold amounts from the employees on the basis of the maximum number specified in any written notices from the Service under § 31.3402(f)(2)–1(g)(5).

.06 Transfer of Forms W–4 furnished electronically. If the predecessor and successor both maintain an electronic system for use by employees in filing Forms W–4, and the systems are compatible, the predecessor may electronically transfer the Forms W–4 of the acquired employees to the successor. The successor may also choose to acquire and maintain the predecessor’s system. If these options do not apply, an acquired employee must provide the successor with a new Form W–4, either electronically or on paper, as prescribed by the successor.

.07 Forms W–5. The predecessor must transfer to the successor all Forms W–5 for the current year that were provided to the predecessor by the acquired employees.

.08 Transfer of Forms W–5 furnished electronically. If the predecessor and successor both maintain an electronic system for use by employees in furnishing Forms W–5, and the systems are compatible, the predecessor may electronically transfer the Forms W–5 of the acquired employees to the successor. The successor may also choose to acquire and maintain the predecessor’s system. If these options do not
apply, an acquired employee must provide the successor with a new Form W–5, either electronically or on paper, as prescribed by the successor.

SECTION 6. PROCEDURE AFTER STATUTORY MERGER OR CONSOLIDATION

.01 Surviving corporation. After a statutory merger or consolidation, if the wages paid and the taxes withheld by the acquired corporation are to be included on the Forms W–2 (Copy A) filed by the surviving corporation, there will be a difference between the amounts shown on the surviving corporation’s Forms W–2 (Copy A) and its Forms 941. The surviving corporation should use Schedule D (Form 941) to explain the discrepancies between Forms W–2 (Copy A) and Forms 941 in the totals of social security wages, Medicare wages and tips, social security tips, federal income tax withheld, and advance earned income credit (EIC) payments. Schedule D (Form 941) should be filed after Forms W–2 (Copy A) are prepared. Thus, Schedule D (Form 941) should be filed with the first quarter return for the year after the calendar year of the statutory merger or consolidation, or with the final Form 941 if the surviving corporation is filing a final return and it is due before the first quarter return for the year after the calendar year of the statutory merger or consolidation. If Form 941 is filed electronically, an employer will be able to file Schedule D (Form 941) separately on paper, until the electronic specifications for Schedule D (Form 941) become available.

.02 Notice under Rev. Rul. 62–60. As described in Rev. Rul. 62–60, a surviving corporation should provide certain information to the Service after a statutory merger or consolidation. A completed Schedule D (Form 941) will include notice that a statutory merger or consolidation has taken place, the date of the change, and the name, trade name, address, telephone number, and employer identification number of the acquired corporation. Thus, if the surviving corporation completes and files Schedule D (Form 941) to explain discrepancies between the totals on Forms W–2 (Copy A) and the totals on Forms 941, Schedule D (Form 941) will also provide notice of a statutory merger or consolidation under Rev. Rul. 62–60.

.03 Acquired corporation. To the extent the wages paid and the taxes withheld by the acquired corporation are to be included in the Forms W–2 (Copy A) by the surviving corporation, there may be amounts shown on the acquired corporation’s Forms 941 which are not shown on Forms W–2 (Copy A) reported under the employer identification number of the acquired corporation. If an acquired corporation files a final Form 941, it should also file a Schedule D (Form 941) with the Form 941 to explain any discrepancies between Forms W–2 (Copy A) and Forms 941 in the totals of social security wages, Medicare wages and tips, social security tips, federal income tax withheld, and advance earned income credit (EIC) payments caused by acquisitions, statutory mergers, or consolidations that are effective after December 31, 2004.

.04 Forms W–5 - Transfer of Forms W–5 furnished electronically. Employers are permitted to apply the rules in section 5.08 regarding Forms W–5 submitted electronically by employees on or after January 19, 1999, the date Announcement 99–3 was published in the Internal Revenue Bulletin.

SECTION 7. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 96–60 is superseded. Rev. Rul. 96–60 is amplified to provide that, if the surviving corporation completes and files Schedule D (Form 941) to explain discrepancies between the totals on Forms W–2 (Copy A) and the totals on Forms 941, Schedule D (Form 941) will also provide notice of a statutory merger or consolidation under Rev. Rul. 62–60.

SECTION 8. EFFECTIVE DATES

.01 Schedule D (Form 941) - Acquisitions, statutory mergers, or consolidations effective after December 31, 2004. Schedule D (Form 941) should be used to explain the discrepancies between Forms W–2 (Copy A) and Forms 941 in the totals of social security wages, Medicare wages and tips, social security tips, federal income tax withheld, and advance earned income credit (EIC) payments caused by acquisitions, statutory mergers, or consolidations that are effective after December 31, 2004.

.02 Forms W–5 - Transfer of Forms W–5 furnished electronically. Employers are permitted to apply the rules in section 5.08 regarding Forms W–5 submitted electronically by employees on or after January 19, 1999, the date Announcement 99–3 was published in the Internal Revenue Bulletin.

DRAFTING INFORMATION

The principal authors of this revenue procedure are Margaret A. Owens and A. G. Kelley of the Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities). For further information regarding this revenue procedure, contact Ms. Owens or Mr. Kelley at (202) 622–6040 (not a toll-free call).
NOTE: This revenue procedure will be reprinted as the next revision of IRS Publication 1141, *General Rules and Specifications for Substitute Forms W-2 and W-3.*

26 CFR 601.602: Tax forms and instructions.
(Also Part I, Sections 6041, 6051, 6071, 6081, 6091; 1.6041–1, 1.6041–2, 31.6051–1, 31.6051–2, 31.6071(a)–1, 31.6081(a)–1, 31.6091–1.)

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Part A. General

Section 1. Purpose

.01 The purpose of this revenue procedure is to provide general rules and specifications from the Internal Revenue Service (IRS) and the Social Security Administration (SSA) for paper substitute forms for Form W-2, Wage and Tax Statement, and Form W-3, Transmittal of Wage and Tax Statements, for wages paid during the 2004 calendar year.

.02 For purposes of this revenue procedure, substitute Form W-2 (Copy A) and substitute Form W-3 are forms that are not printed by the IRS. Copy A or any other copies of a substitute Form W-2 or a substitute Form W-3 must conform to the specifications in this revenue procedure to be acceptable to the IRS and the SSA. No IRS office is authorized to allow deviations from this revenue procedure. Preparers should also refer to the separate 2004 Instructions for Forms W-2 and W-3 for details on how to complete these forms. See Part C, Section 4, for information on obtaining the official IRS forms and instructions. See Part B, Section 2, for requirements for the copies of substitute forms furnished to employees.

.03 For purposes of this revenue procedure, the official, IRS-printed red dropout ink Forms W-2 (Copy A) and W-3 and their exact substitutes are referred to as “red-ink.” The SSA-approved, laser-printed, black-and-white Forms W-2 (Copy A) and W-3 are referred to as “laser-printed.”

Any questions about the red-ink Form W-2 (Copy A) and Form W-3 should be emailed to taxforms@irs.gov or sent to:
Internal Revenue Service
Attn: Substitute Forms Program
SE:W:CAR:MP:T:T:SP, Room 6516
1111 Constitution Ave., N.W.
Washington, DC 20224

Any questions about the black-and-white laser-printed Form W-2 (Copy A) and Form W-3 should be emailed to laser.forms@ssa.gov or sent to:

Social Security Administration
Data Operations Center
Attn: Laser Forms Approval, Room 359
1150 E. Mountain Drive
Wilkes-Barre, PA 18702-7997

Also, see Sections 3.05 and 3.06 of Part I.

Note. You should receive a response within 30 days from either the IRS or the SSA.

.04 The IRS maintains a centralized call site at its Martinsburg Computing Center (IRS/MCC) to answer questions related to information returns (Forms W-2, W-3, 1099 series, 1096, etc.). You can reach the call site at 304-263-8700 (not a toll-free number) or 1-866-455-7438 (toll-free). The Telecommunication Device for the Deaf (TDD) number is 304-267-3367 (not a toll-free number). The hours of operation are Monday through Friday from 8:30 a.m. to 4:30 p.m. Eastern time. You may also send questions to the call site via the Internet at mccip@irs.gov. IRS/MCC does not process Forms W-2 (Copy A), Forms W-2 (Copy A) prepared on paper and/or magnetically/electronically must be filed with the SSA. IRS/MCC does, however, process waiver requests (Form 8508, Request for Waiver From Filing Information Returns Magnetically) and extension of time to file requests (Form 8809, Request for Extension of Time To File Information Returns) for Forms W-2 (Copy A) and requests for an extension of time to furnish the employee copies of Form W-2. See Publication 1220, Specifications for Filing Forms 1098, 1099, 5498 and W-2G Electronically or Magnetically, for information on waivers and extensions of time.

.05 The following publications provide detailed filing procedures for certain information returns:

• 2004 Instructions for Forms W-2 and W-3,
• Instructions for Forms W-2c and W-3c (Rev. December 2002), and
• Publication 1223, General Rules and Specifications for Substitute Forms W-2c and W-3c.

Section 2. What's New

.01 The IRS has changed the dimensions of the 2004 Forms W-2 (Copy A) and W-3 (Exhibits A and B) to match those shown for SSA laser-printed forms in Exhibits E and F.

.02 The width of red-ink Forms W-2 and W-3 is now 7.5 inches.

.03 The top and side margins for red-ink Forms W-2 and W-3 are now .5 inches.

Note. The top margin of red-ink Form W-3 is .5 inches from the top line of the form to the top of the page.

.04 The space between the two Forms W-2 (Copy A) on both the red-ink and laser-printed versions of substitute Form W-2 should be 1.33 inches.

.05 On both red-ink Forms W-2 (Copy A) and W-3, the combined width of the “Control number” (box a) and form identification number (“22222” or “33333”) boxes has been reduced to 2.5 inches.

.06 Dollar signs and shading in dollar-entry boxes have been removed from red-ink Form W-2 (Copy A) and Form W-3 to provide more space.

.07 The Privacy Act and Paperwork Reduction Act Notice has been moved to the back of Copy D of Form W-2.

.08 Other changes to dimensions and format of red-ink Forms W-2 (Copy A) and W-3 have been made for 2004. (See Exhibits A and B.)

.09 Electronic payee statements (Copies B, C, and 2 of Form W-2) may be furnished if employees give their consent (as described in Treasury Regulations Section 31-6501-1(j)). See Publication 15-A, Employer’s Supplemental Tax Guide, for details.

.10 Sections 3 and 4 of Part A of the last revision of Publication 1141 were reversed in this revision. Some subsections were moved and renumbered for better readability.

.11 Editorial changes were made. Redundancies were eliminated as much as possible.

Section 3. General Rules for Paper Forms W-2 and W-3

.01 Employers not filing magnetically or electronically must file paper Forms W-2 (Copy A) along with Form W-3 with the SSA by using either the official IRS form or a substitute form that exactly meets the specifications shown in Parts B and C of this revenue procedure.

**Note.** Substitute territorial forms (W-2AS, W-2GU, W-2VI) should also conform to the specifications as outlined in this revenue procedure. These forms require the form designation (“W-2AS,” “W-2GU,” “W-2VI”) on Copy A to be in black ink. Also, you must use bond paper for Copies 1 and B of Form W-2VI.

Employers who file with the SSA magnetically, electronically, or on paper may design their own statements to furnish to employees. These employee statements designed by employers must comply with the requirements shown in Parts B and C.

.02 Red-ink substitute forms that completely conform to the specifications contained in this revenue procedure may be privately printed without prior approval from the IRS or the SSA. Only the black-and-white laser-printed forms need to be submitted to the SSA for approval (see Section 1B of Part B).

.03 As in the past, Form W-2 (Copy A) and Form W-3 may be generated using a laser-printer by following all guidelines and specifications (also see Section 1B of Part B). In general, regardless of the method of entering data, using black ink on Forms W-2 and W-3 provides better readability for processing by scanning equipment. Colors other than black are not easily read by the scanner and may result in delays or errors in the processing of Forms W-2 (Copy A) and W-3. The printing of the data should be centered within the boxes. Type must be substantially identical in size (not below 10-point) and shape to the official forms.

**Note.** With the exception of the identifying number and the corner register marks, the preprinted form layout for the red-ink Forms W-2 (Copy A) and W-3, must be in Flint J-6983 red OCR dropout ink or an exact match. (See Section 1A.03 of Part B.)

.04 Substitute forms filed with the SSA and substitute copies furnished to employees that do not conform to these specifications are unacceptable. Forms W-2 (Copy A) and W-3 filed with the SSA that do not conform may be returned. In addition, penalties may be assessed for not complying with the form specifications.

.05 If you are uncertain of any specification and want it clarified:

1. Submit a letter or email citing the specification to the addresses in the next section,
2. State your interpretation of that specification, and
3. Enclose an example (if appropriate) of how the form would appear if produced using your understanding of the specification.
4. Be sure to include your name, complete address, phone number, and if applicable, your email address with your correspondence.

.06 Any questions about the specifications, especially those for the red-ink Form W-2 (Copy A) and Form W-3, should be emailed to *taxforms@irs.gov* or sent to:

Internal Revenue Service  
Attn: Substitute Forms Program  
SE:W:CAR:MP:T:T:SP, Room 6516  
1111 Constitution Ave., N.W.  
Washington, DC 20224

Any questions about the black-and-white laser-printed Form W-2 (Copy A) and Form W-3 should be emailed to *laserforms@ssa.gov* or sent to:

Social Security Administration  
Data Operations Center  
Attn: Laser Forms Approval, Room 359  
1150 E. Mountain Drive  
Wilkes-Barre, PA 18702-7997

**Note.** You should receive a response within 30 days from either the IRS or the SSA.

.07 Forms W-2 and W-3 are subject to annual review and possible change. Therefore, employers are cautioned against overstocking supplies of privately-printed substitutes.

.08 Separate instructions for Forms W-2 and W-3 are provided in the 2004 Instructions for Forms W-2 and W-3. Form W-3 should be used only to transmit paper Forms W-2 (Copy A). Form W-3 is a single sheet including only essential filing information. Be sure
to make a copy of your completed Form W-3 for your records. Copies of the current year official IRS Forms W-2 and W-3, and the instructions for those forms, may be obtained from most IRS offices or by calling 1-800-829-3676. The IRS provides only cutsheet sets of Forms W-2 and cutsheets of Form W-3. The instructions and information copies of the forms may be found on the IRS website at www.irs.gov.

.09 Because substitute Forms W-2 (Copy A) and W-3 are machine-imaged and scanned by the SSA, the forms must meet the same specifications as the official IRS Forms W-2 and W-3 (as shown in the exhibits).

Section 4. General Rules for Filing Forms W-2 (Copy A) or W-3 Magnetically or Electronically

.01 Employers must file Forms W-2 (Copy A) with the SSA electronically or with magnetic media if they file 250 or more calendar year 2004 Forms W-2 (Copy A). The SSA publication MMREF-1, Magnetic Media Reporting and Electronic Filing, contains specifications and procedures for filing Form W-2 information with the SSA magnetically or electronically. Employers are cautioned to obtain the most recent revision of MMREF-1 (and supplements) due to any subsequent changes in specifications and procedures.

.02 You may obtain a copy of the MMREF-1 by:

- Accessing the SSA website at www.socialsecurity.gov/employer/pub.htm,
- Writing to:
  Social Security Administration
  OCO, DES; Attn: Employer Reporting Services Center
  300 North Greene Street
  Baltimore, MD 21290-0300
- Calling your local SSA Employer Services Liaison Officer (ESLO) (the ESLOs’ phone numbers are available at www.socialsecurity.gov/employer/wage_reporting_specialists.htm), or
- Calling the SSA’s Employer Reporting Assistance staff at 1-800-772-6270.

.03 Magnetic media or electronic filers do not file a paper Form W-3. See the SSA publication MMREF-1 for guidance on transmitting Form W-2 (Copy A) information to SSA magnetically or electronically.

.04 Employers who do not comply with the magnetic media or electronic filing requirements for Form W-2 (Copy A) and who are not granted a waiver by the IRS may be subject to penalties. Employers who file Form W-2 information with the SSA on magnetic media or electronically must not send the same data to the SSA on paper Forms W-2 (Copy A). Any duplicate reporting may subject filers to unnecessary contacts by the SSA or the IRS.

Part B. Specifications for Substitute Forms W-2 and W-3

Section 1A. Specifications for “Red-Ink” Substitute Form W-2 (Copy A) and Form W-3 Filed with the SSA

.01 The official IRS-printed red dropout ink Form W-2 (Copy A) and W-3 and their exact substitutes are referred to as “red-ink” in this revenue procedure. Employers may file substitute Forms W-2 (Copy A) and W-3 with the SSA. The substitute forms must be exact replicas of the official IRS forms with respect to layout and content because they will be read by scanner equipment.

.02 Paper used for cutsheets and continuous-pinned forms for substitute Form W-2 (Copy A) and Form W-3 that are to be filed with the SSA must be white 100% bleached chemical wood, 18-20 pound paper only, optical character recognition (OCR) bond produced in accordance with the following specifications:

- Acidity: Ph value, average, not less than ................................................................. 4.5
- Basis Weight: 17 x 22 inch 500 cut sheets, pound ....................................................... 18-20
- Metric equivalent—gm./sq. meter
  (a tolerance of +5 pct. is allowed) .................................................................................. 68-75
- Stiffness: Average, each direction, not less than—milligrams ........................................ 50
- Cross direction ........................................................................................................... 80
- Machine direction ...................................................................................................... 40
- Tearing strength: Average, each direction, not less than—grams. ................................. 40
Note. Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met.

.03 All printing of substitute Forms W-2 (Copy A) and W-3 must be in Flint red OCR dropout ink except as specified below. The following must be printed in nonreflective black ink:

- Identifying number “22222” or “33333” at the top of the forms.
- Tax year at the bottom of the forms using 24-point OCR-A font.
- The four (4) corner register marks on the forms.
- The jurat and “Signature, Title, Date” line at the bottom of Form W-3.
- The form identification number (“W-3”) at the bottom of Form W-3.

All the instructions below Form W-3 beginning with “Send this entire page....” line to the bottom of Form W-3.

.04 The vertical and horizontal spacing for all federal payment and data boxes on Forms W-2 and W-3 must meet specifications. On Form W-3 and Form W-2 (Copy A), all the perimeter rules must be 1-point (0.014-inch), while all other rules must be one-half point (0.007-inch). Vertical rules must be parallel to the left edge of the form; horizontal rules parallel to the top edge.

.05 The official red-ink Form W-3 and Form W-2 (Copy A) are 7.5 inches wide. Employers filing Forms W-2 (Copy A) with the SSA on paper must also file a Form W-3. One Form W-3 is printed on a standard-size, 8.5 x 11-inch page. Two official Forms W-2 (Copy A) are contained on a single 8.5 x 11-inch page (exclusive of any snap-stubs).

.06 The top, left, and right margins for the Form W-2 (Copy A) and Form W-3 are .5 inches (½ inch). All margins must be free of printing except for the words “DO NOT STAPLE OR FOLD” on red-ink Form W-3. The space between the two Forms W-2 (Copy A) is 1.33 inches.

.07 The identifying numbers are “22222” for Form W-2 (Copies A (and 1)) and “33333” for Form W-3. No printing should appear anywhere near the identifying numbers. For both Form W-2 (Copy A) and Form W-3, the combination width of box a (Control number) and the box containing the identifying number must be 2.5 inches.

Note. The identifying number must be printed in nonreflective black ink in OCR-A font of 10 characters per inch.

.08 The depth of the individual scannable image on a page must be the same as that on the official IRS forms. The depth from the top line to the bottom line of an individual Form W-2 (Copy A) must be 4.17 inches and the depth from the top line to the bottom line of Form W-3 must be 4.67 inches. (See Exhibits A and B.)

.09 Continuous-pINFed Forms W-2 (Copy A) must be separated into 11-inch deep pages. The pinfed strips must be removed when Forms W-2 (Copy A) are filed with the SSA. The two Forms W-2 (Copy A) on the 11-inch page must not be separated (only the pages are to be separated (burst)). The words “Do Not Cut, Fold, or Staple Forms on This Page” must be printed twice between the two Forms W-2 (Copy A) in Flint red OCR dropout ink. Perforations are required on all other copies (Copies 1, B, C, 2, and D) to enable the separation of individual forms.

.10 Box 12 of Form W-2 (Copy A) contains four entry boxes – 12a, 12b, 12c, and 12d. Do not make more than one entry per box. Enter your first code in box 12a (for example, enter Code D in box 12a, not 12d, if it is your first entry). If more than four items need to be reported in box 12, use a second Form W-2 to report the additional items (see “Multiple forms” in the 2004 Instructions for Forms W-2 and W-3). Do not report the same federal tax data to the SSA on more than one Form W-2 (Copy A). However, repeat the identifying information (employee’s name and SSN, employer’s name, address, and EIN) on each additional form.
.11 The checkboxes in box 13 of Form W-2 (Copy A) must be .14 inches each; the space before the 1st checkbox is .20 inches; the spacing on each remaining side of the 3 checkboxes is .36 inches (see Exhibit A). The checkboxes in box b of Form W-3 must also be .14 inches (see Exhibit B for other dimensions in box b).

Note. More than 50% of an applicable checkbox must be covered by an “X.”

.12 All substitute Forms W-2 (Copy A) and W-3 in the red-ink format must have the tax year, form number, and form title printed on the bottom face of each form using type identical to that of the official IRS form. The red-ink substitute Form W-2 (Copy A) and Form W-3 must have the form producer’s EIN entered directly to the left of “Department of the Treasury,” in red.

.13 The words “For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.” must be printed in Flint red OCR dropout ink in the same location as on the official Form W-2 (Copy A). The words “For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D of Form W-2.” must be printed at the bottom of the page of Form W-3.

.14 The Office of Management and Budget (OMB) Number must be printed on substitute Forms W-3 and W-2 (on each ply) in the same location as on the official IRS forms.

.15 All substitute Forms W-3 must include the instructions that are printed on the same sheet below the official IRS form.

.16 The back of substitute Form W-2 (Copy A) and Form W-3 must be free of all printing.

.17 All copies must be clearly legible. Hot wax and cold carbon spots are not permitted for Form W-2 (Copy A). Interleaved carbon should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

.18 Chemical transfer paper is permitted for Form W-2 (Copy A) only if the following standards are met:

- Only chemically-backed paper is acceptable for Form W-2 (Copy A). Front and back chemically-treated paper cannot be processed properly by scanning equipment.
- Chemically-transferred images must be black.
- Carbon-coated forms are not permitted.

.19 The Government Printing Office (GPO) symbol and the Catalog Number (Cat. No.) must be deleted from substitute Form W-2 (Copy A) and Form W-3.

Section 1B. Specifications for “Laser-Printed” Substitute Form W-2 (Copy A) and Form W-3 Filed with the SSA

.01 The SSA-approved, laser-printed, black-and-white Forms W-2 (Copy A) and W-3 are referred to as “laser-printed.” Specifications for the laser-printed black-and-white Forms W-2 (Copy A) and W-3 are similar to the red-ink forms (Part B, Section 1A) except for the items that follow (see Exhibits E and F). Exhibits are samples only and must not be downloaded to meet tax obligations.

(1) Forms must be printed on 8.5 x 11-inch single-sheet paper only, not on continuous-feed using a laser printer. There must be two Forms W-2 (Copy A) printed on a page. There must be no horizontal perforations between the two Forms W-2 (Copy A) on each page.

(2) All forms and data must be printed in nonreflective black ink only.

(3) The data and forms must be programmed to print simultaneously. Forms cannot be produced separately from wage data entries.

(4) The forms must not contain corner register marks.

(5) The forms must not contain any shaded areas including those boxes that are entirely shaded on the red-ink forms.

(6) Identifying numbers on both Form W-2 (“22222”) and Form W-3 (“33333”) must be preprinted in 14-point Arial bold font or a close approximation.

(7) The form numbers (“W-2” and “W-3”) must be in 18-point Arial font or a close approximation. The tax year (“2004”) on Forms W-2 (Copy A) and W-3 must be in 20-point Arial font or a close approximation.

(8) No part of the box titles or the data printed on the forms may touch any of the vertical or horizontal lines, nor should any of the data intermingle with the box titles. The data should be centered in the boxes.
(9) Do not print any information in the margins of the laser-printed forms (for example, do not print “DO NOT STAPLE OR FOLD” in the top margin of Form W-3).

(10) The word “Code” must not appear in box 12 on Form W-2 (Copy A).

(11) A 4-digit vendor code preceded by four zeros and a slash (for example, 0000/1234) must appear in 12-point Arial font, or a close approximation, under the tax year in place of the Cat. No. on Form W-2 (Copy A) and in the bottom right corner of the “For Official Use Only” box at the bottom of Form W-3. Do not display the form producer’s EIN to the left of “Department of the Treasury.” The vendor code will be used to identify the form producer.

(12) Do not print Catalog Numbers (Cat. No.) on either form (10134D for Form W-2 (Copy A); 10159Y for Form W-3).

(13) Do not print the checkboxes in:

- Box b of Form W-3. The “X” should be programmed to be printed and centered directly below the applicable “Kind of Payer.”

- The “Void” box of Form W-2 (Copy A). The “X” should be programmed to be printed to the right of “Void” because of space limitations.

- Box 13 of Form W-2 (Copy A). The “X” should be programmed to be printed and centered directly below the applicable box title.

(14) Do not print dollar signs. If there are no money amounts being reported, the entire field should be left blank.

(15) The space between the two Forms W-2 (Copy A) is 1.33 inches.

.02 You must submit samples of your laser-printed substitute forms to the SSA. Only laser-printed, black-and-white substitute Forms W-2 (Copy A) and W-3 for tax year 2004 will be accepted for approval by the SSA. Questions regarding other forms (that is, red-ink Forms W-2c, W-3c, 1099 series, 1096, etc.) must be directed to the IRS.

.03 You will be required to send one set of blank and one set of dummy-data, laser-printed substitute Forms W-2 (Copy A) and W-3 for approval. Sample data entries should be filled in to the maximum length for each box entry, preferably using numeric data or alpha data, depending upon the type required to be entered. Include in your submission the name, telephone number, fax number, and email address of a contact person who can answer questions regarding your sample forms.

.04 To receive approval, you may first contact the SSA at laser.forms@ssa.gov to obtain a template and further instructions in pdf or Excel format. You may also send your 2004 sample, laser-printed substitute forms to:

Social Security Administration
Data Operations Center
Attn: Laser Forms Approval, Room 359
1150 E. Mountain Drive
Wilkes-Barre, PA 18702–7997

Send your sample forms via private mail carrier or certified mail in order to verify their receipt. You can expect approval (or disapproval) by the SSA within 30 days of receipt of your sample forms.

.05 The 4-digit vendor code preceded by four zeros and a slash (0000/) must be preprinted on the sample, laser-printed substitute forms. Forms not containing a vendor code will be rejected and will not be submitted for testing or approval. If you do not have a vendor code, you may contact the National Association of Computerized Tax Processors via email at president@nactp.org.

.06 If you use forms produced by a vendor and have questions concerning approval, do not send the forms to the SSA for approval. Instead, you may contact the software vendor to obtain a copy of SSA’s dated approval notice supplied to that vendor.

Section 2. Requirements for Substitute Forms Furnished to Employees (Copies B, C, and 2 of Form W-2)

Note. Printers are cautioned that the rules in Part B, Section 2, apply only to employee copies of Form W-2 (Copies B, C, and 2).

.01 All employers (including those who file on magnetic media or electronically) must furnish employees with at least two copies of Form W-2 (three or more for employees required to file a state, city, or local income tax return). The following rules are guidelines for preparing employee copies.
The dimensions of these copies (Copies B, C, and 2), but not Copy A, may differ from the dimensions of the official IRS form to allow space for reporting additional information, including additional entries such as withholding for health insurance, union dues, bonds, or charity in box 14. The limitation of a maximum of four items in box 12 of Form W-2 applies only to Copy A, which is filed with the SSA.

**Note.** Electronic payee statements (Copies B, C, and 2 of Form W-2) may now be furnished if employees give their consent (as described in Treasury Regulations Section 31-6501-1(j)). See Publication 15-A, Employer’s Supplemental Tax Guide, for details.

**.02** The minimum dimensions for employee copies only (not Copy A) of Form W-2 should be 2.67 inches deep by 4.25 inches wide. The maximum dimensions should be no more than 6.5 inches deep by no more than 8.5 inches wide.

**Note.** The maximum and minimum size specifications are for tax year 2004 only and may change in future years.

**.03** Either horizontal or vertical format is permitted (see Exhibit D).

**.04** The paper for all copies must be white and printed in black ink. The substitute Copy B, which employees are instructed to attach to their federal income tax returns, should be at least 9-pound paper (basis 17 x 22-500). Other copies furnished to employees should also be at least 9-pound paper (basis 17 x 22-500).

**.05** Employee copies of Form W-2 (Copies B, C, and 2), including those that are printed on a single sheet of paper, must be easily separated. Providing perforations between the individual copies satisfies this requirement, but using scissors to separate Copies B, C, and 2 does not.

**Note.** The perforation requirement in this section does not apply to printouts of copies of Forms W-2 that are furnished electronically to employees (as described in Treasury Regulations Section 31-6051-1(j)). However, these employees should be cautioned to carefully separate the copies of Form W-2. See Publication 15-A, Employer’s Supplemental Tax Guide, for information on electronically furnishing Forms W-2 to employees.

**.06** Interleaved carbon and chemical transfer paper employee copies must be clearly legible. Hot wax and cold-carbon spots are not permitted for employee copies. All copies must be able to be photocopied. Interleaved carbon should be black and must be of good quality to assure legibility on all copies and to avoid smudging. Fading must be minimized to assure legibility.

**.07** The electronic tax logo on the IRS official employee copies is not required on any of the substitute form copies. To avoid confusion and questions by employees, employers are encouraged to delete the identifying number (“22222”) and the word “Void” and its associated checkbox from the employee copies of Form W-2.

**.08** All substitute employee copies must contain boxes, box numbers, and box titles that match the official IRS Form W-2. Boxes that do not apply can be deleted. However, certain core boxes must be included. The placement, numbering, and size of this information is specified as follows:

- The items and box numbers that constitute the core data are:

  - Box 1 — Wages, tips, other compensation,
  - Box 2 — Federal income tax withheld,
  - Box 3 — Social security wages,
  - Box 4 — Social security tax withheld,
  - Box 5 — Medicare wages and tips, and
  - Box 6 — Medicare tax withheld.

  The core boxes must be printed in the exact order shown on the official IRS form.

- The core data boxes (1 through 6) must be placed in the upper right of the form. Substitute vertical-format copies may have the core data across the top of the form (see Exhibit D). In no instance, will boxes or other information be permitted to the right of the core data.

- The form title, number, or copy designation (B, C, or 2) may be at the top of the form. Also, a reversed or blocked-out area to accommodate a postal permit number or other postal considerations is allowed in the upper-right.

- Boxes 1 through 6 must each be a minimum of 1 3/8 inches wide x 1/4 inch deep.
• Other required boxes are:
  
  b) Employer identification number (EIN),
  
  c) Employer’s name, address, and ZIP code,
  
  d) Employee’s social security number,
  
  e) Employee’s name, and
  
  f) Employee’s address and ZIP code.

Identifying items must be present on the form and be in boxes similar to those on the official IRS form. However, they may be placed in any location other than the top or upper right. You do not need to use the lettering system (b-f) used on the official IRS form. The employer identification number (EIN) may be included with the employer’s name and address and not in a separate box.

Note. Box a (“Control number”) is not required.

.09 All copies of Form W-2 furnished to employees must clearly show the form number, the form title, and the tax year prominently displayed together in one area of the form. The title of Form W-2 is “Wage and Tax Statement.” It is recommended (but not required) that this be located on the bottom left of substitute Forms W-2. The reference to the “Department of the Treasury — Internal Revenue Service” must be on all copies of substitute Forms W-2 furnished to employees. It is recommended (but not required) that this be located on the bottom right of Form W-2.

.10 If the substitute employee copies are labeled, the forms must contain the applicable description:

• “Copy B, To Be Filed With Employee’s FEDERAL Tax Return.”

• “Copy C, For EMPLOYEE’S RECORDS.”

• “Copy 2, To Be Filed With Employee’s State, City, or Local Income Tax Return.”

  It is recommended (but not required) that these be located on the lower left of Form W-2. If the substitute employee copies are not labeled as to the disposition of the copies, then written notification using similar wording must be provided to each employee.

.11 The tax year (2004) must be clearly printed in nonreflective black ink on all copies of substitute Form W-2. It is recommended (but not required) that this information be in the middle at the bottom of the Form W-2. The use of 24-pt. OCR-A font is recommended (but not required).

.12 Boxes 1, 2, and 9 (if applicable) on Copy B must be outlined in bold 2-point rule or highlighted in some manner to distinguish them. If “Allocated tips” are being reported, it is recommended (but not required) that box 8 also be outlined. If reported, “Social security tips” (box 7) must be shown separately from “Social security wages” (box 3).

Note. Boxes 8 and 9 may be omitted if not applicable.

.13 If employers are required to withhold and report state or local income tax, the applicable boxes are also considered core information and must be placed at the bottom of the form. State information is included in:

• Box 15 (State, Employer’s state ID number)

• Box 16 (State wages, tips, etc.)

• Box 17 (State income tax)

Local information is included in:

• Box 18 (Local wages, tips, etc.)

• Box 19 (Local income tax)

• Box 20 (Locality name)

.14 Boxes 7 through 14 may be omitted from substitute employee copies unless the employer must report any of that information to the employee. For example, if an employee did not have “Social security tips” (box 7), the form could be printed without that box. But if an employer provided dependent care benefits, the amount must be reported separately, shown in box 10, and labeled “Dependent care benefits.”

.15 Employers may enter more than four codes in box 12 of substitute Copies B, C, and 2 (and 1 and D) of Form W-2, but each entry must use Codes A-W (see the 2004 Instructions for Forms W-2 and W-3).
.16 If an employer has employees in any of the three categories in box 13, all checkboxes must be shown and the proper checkmark
made, when applicable.

.17 Employers may use box 14 for any other information that they wish to give to their employees. Each item must be labeled.
(See the instructions for box 14 in the 2004 Instructions for Forms W-2 and W-3.)

.18 The front of Copy C of a substitute Form W-2 must contain the note “This information is being furnished to the Internal Revenue
Service. If you are required to file a tax return, a negligence penalty or other sanction may be imposed on you if this income is taxable
and you fail to report it.”

.19 Instructions similar to those contained on the back of Copies B and C of the official IRS Form W-2 must be provided to
each employee. An employer may modify or delete instructions that do not apply to its employees. (For example, remove Railroad
Retirement Tier 1 and Tier 2 compensation information for nonrailroad employees or information about dependent care benefits that
the employer does not provide.)

.20 Employers must notify their employees who have no income tax withheld that they may be able to claim a tax refund because
of the earned income credit (EIC). They will meet this notification requirement if they furnish a substitute Form W-2 with the EIC
notice on the back of Copy B, IRS Notice 797, Possible Federal Tax Refund Due to the Earned Income Credit (EIC), or on their
own statement containing the same wording. They may also change the font on Copy C so that the EIC notification and Form W-2
instructions fit entirely on the back. For more information about notification requirements, see Notice 1015, Have You Told Your
Employees About the Earned Income Credit (EIC)?

Part C. Additional Instructions

Section 1. Additional Instructions for Form Printers

.01 If magnetic or electronic media is not used for filing with the SSA, the substitute copies of Forms W-2 (either red-ink or
laser-printed) should be assembled in the same order as the official IRS Forms W-2. Copy A should be first, followed sequentially
by perforated sets ( Copies 1, B, C, 2, and D).

.02 The substitute form to be filed by the employer with the SSA must carry the designation “Copy A.”

Note. Magnetic media/electronic filers do not submit either red-ink or laser-printed paper Form W-2 (Copy A) or Form W-3 to the
SSA.

.03 Substitute forms (red-ink or laser-printed) do not require a copy to be retained by employers (Copy D of Form W-2). However,
employers must be prepared to verify or duplicate the information if it is requested by the IRS or the SSA. Paper filers who do not
keep a Form W-2 (Copy D) should be able to generate a facsimile of Form W-2 (Copy A) in case of loss.

.04 Except for copies in the official assembly, no additional copies that may be prepared by employers should be placed ahead of
Form W-2 (Copy C) “For EMPLOYEE’S RECORDS.”

.05 Instructions similar to those contained on the back of Copies B and C of the official IRS Form W-2 must be provided to each
employee. These instructions may be printed on the back of the substitute Copies B and C or may be provided to employees on a
separate statement. Do not print these instructions on the back of Copy 1 or 2 that is to be filed with the employee’s state, city, or
local income tax return. Any Forms W-2 (Copy A) and W-3 that are filed with the SSA must have no printing on the reverse side.
Instructions similar to those provided as part of the IRS official forms must be provided as part of any substitute Form W-2 (Copy A)
or Form W-3.

Section 2. Instructions for Employers

.01 Only originals of Form W-2 (Copy A) and Form W-3 may be filed with the SSA. Carbon copies and photocopies are unaccept-
able.

.02 Employers should type or machine-print data entries on the non-laser-generated forms whenever possible. Ensure good quality
by using a high-quality type face, inserting data in the middle of blocks that are well separated from other printing and guidelines, and
taking any other measures that will guarantee clear, sharp images. Black ink must be used with no script type, inverted font, italics or
dual-case alpha characters.

Note. 12-point Courier font is preferred by the SSA.

.03 Form W-2 (Copy A) requires decimal entries for wage data. Dollar signs should not be printed with money amounts on the
Forms W-2 (Copy A) and W-3.

.04 The employer must provide a machine-scannable Form W-2 (Copy A). The employer must also provide payee copies (Copies
B, C, and 2) that are legible and able to be photocopied (by the employee). Do not print any data in the top margin of the payee copies
of the forms.
Any printing in box a (Control number) on Forms W-2 or W-3 may not touch any vertical or horizontal lines and should be centered in the box.

The filer’s employer identification number (EIN) must be entered in box b of Form W-2 and box e of Form W-3. The EIN entered on Form(s) W-2 (box b) and Form W-3 (box e) must be the same as on Forms 941, 943, CT–1, Schedule H (Form 1040), or any other corresponding forms filed with the IRS. Be sure to use EIN format (00-0000000) rather than SSN format (000-00-0000).

The employer’s name, address, and EIN may be preprinted.

Employers should use the official IRS-preprinted Form W-3 that they received with Publication 393 or Publication 2184, if available, when filing red-ink Forms W-2 (Copy A) with the SSA.

Section 3. OMB Requirements for Both Red-Ink and Laser-Printed Substitute Forms

The Paperwork Reduction Act (the Act) of 1995 (Public Law 104-13) requires that:

- The OMB approves all IRS tax forms that are subject to the Act.
- Each IRS form contains (in or near the upper right corner) the OMB approval number, if any. (The official OMB numbers may be found on the official IRS printed forms and are also shown on the forms in Exhibits A, B, C, E, and F.)
- Each IRS form (or its instructions) states:
  1. Why the IRS needs the information,
  2. How it will be used, and
  3. Whether or not the information is required to be furnished to the IRS.
This information must be provided to any users of official or substitute IRS forms or instructions.

The OMB requirements for substitute IRS forms are:

- Any substitute form or substitute statement to a recipient must show the OMB number as it appears on the official IRS form.
- For Form W-2 (Copy A) and Form W-3, the OMB number must appear exactly as shown on the official IRS form.
- For any copy of Form W-2 other than Copy A, the OMB number must use one of the following formats.
  1. OMB No. XXXX-XXXX (preferred) or
  2. OMB # XXXX-XXXX (acceptable).

Any substitute Form W-2 (Copy A only) must state “For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D.” Any substitute Form W-3 must state “For Privacy Act and Paperwork Reduction Act Notice, see back of Copy D of Form W-2.” If no instructions are provided to users of your forms, you must furnish them with the exact text of the Privacy Act and Paperwork Reduction Act Notice.

Section 4. Copies of Forms

You can obtain official IRS forms and information copies of federal tax materials at local IRS offices or by calling the IRS Distribution Center at 1-800-829-3676. Other ways to get federal tax material include:

- The Internet at www.irs.gov.
- IRS Fax Forms at 703-368-9694.
- The IRS’ CD-ROM.

Only contact the IRS, not the SSA, for forms.

Note. Many IRS forms are provided electronically by fax, on the IRS website, and on the Federal Tax Forms CD-ROM. But copies of Form W-2 (Copy A) and Form W-3 cannot be used for filing with the IRS or SSA when obtained this way because the forms do not meet the specific printing specifications as described in this publication. Copies of Forms W-2 and W-3 obtained from these sources are for information purposes only.

You can access the IRS via the World Wide Web using www.irs.gov.
The IRS also offers an alternative to downloading electronic files and provides current and prior-year access to tax forms and instructions through its Federal Tax Forms CD-ROM. The CD will be available for the upcoming filing season. Order Publication 1796, IRS Federal Tax Products CD-ROM, by using the IRS website at www.irs.gov/cdorders or by calling 1-877-CDFORMS (1-877-233-6767).

Section 5. Effect on Other Documents


List of Exhibits

Exhibit A — Form W-2 (Copy A) (Red-Ink)
Exhibit B — Form W-3 (Red-Ink)
Exhibit C — Form W-2 (Copy B)
Exhibit D — Form W-2 (Alternative Employee Copies) (Illustrating Horizontal and Vertical Formats)
Exhibit E — Form W-2 (Copy A) (Laser-Printed)
Exhibit F — Form W-3 (Laser-Printed)
**Exhibit B**

**Form W-3**

(Red-ink)

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**Form W-3 Transmittal of Wage and Tax Statements**

August 23, 2004

Department of the Treasury

Internal Revenue Service

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**An Item To Note**

Separate instructions. See the 2004 Instructions for Forms W-2 and W-3 for information on completing this form.

**Purpose of Form**

Use this form to transmit Copy A of Form(s) W-2, Wage and Tax Statement, for each employee, of Form(s) W-2 for your records. Use Form W-3 for the current year if only one Form W-2 is being filed. If you are filing Form(s) W-2 on magnetic media or electronically, do not file Form W-3.

**When To File**

File Form W-3 with Copy A of Form(s) W-2 by February 28, 2005.

---

For Privacy Act and Paperwork Reduction Act Notice, see the 2005 Instructions for Forms W-2 and W-3.
<table>
<thead>
<tr>
<th>Form W-2</th>
<th>Wage and Tax Statement</th>
<th>2004</th>
</tr>
</thead>
</table>
| **Exhibit C**
**Form W-2**
(Copy B) | | |
| **Control number** | **Employer identification number** | **Wages, tips, other compensation** | **Federal income tax withheld** |
| **1** | **2** |
| **Social security wages** | **Social security tax withheld** |
| **3** | **4** |
| **Medicare wages and tips** | **Medicare tax withheld** |
| **5** | **6** |
| **Social security tips** | **Allocated tips** |
| **7** | **8** |
| **Advance payments** | **Dependent care benefits** |
| **9** | **10** |
| **Employee’s first name and initial** | **Last name** |
| **11** | **12a** | **See instructions for box 12** |
| **Qualifying plans** | **12b** |
| **13** | **12c** |
| **Other** | **12d** |
| **14** | **13a** |
| **Employee’s address and ZIP code** | **13b** |
| **15** | **13c** |
| **State wages, tips, etc.** | **13d** | **Local income tax** |
| **16** | **17** | **14** | **15** |
| **State income tax** | **Local wages, tips, etc.** |
| **18** | **19** |
| **Local income tax** | **State income tax** |
| **20** | **16** | **17** | **18** |

*Copy B—To BeFiled With Employee’s FEDERAL Tax Return. This information is being furnished to the Internal Revenue Service.*

Visit the IRS website at www.irs.gov
### Exhibit D

**Form W-2: Wage and Tax Statement**

<table>
<thead>
<tr>
<th>Employee identification number</th>
<th>Federal income tax withheld</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Employee’s name, address, and ZIP code</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Employee’s social security number</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Employee’s name</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Employee’s address and ZIP code</strong></td>
<td></td>
</tr>
<tr>
<td><strong>State</strong></td>
<td><strong>State wages, tips, etc.</strong></td>
</tr>
</tbody>
</table>

**Copy C** For EMPLOYEE’S RECORDS, 2004

---

**Horizontal Format**

**Note:** Exhibit D provides examples of employee copies of Form W-2 only. For examples of Copy A, see Exhibit A or Exhibit E. For the specifications of Copy A, which must be filed with the SSA, see Part B, sections 1A and 1B.

The core data boxes are 1 through 6 and, if applicable, 15 through 20. The core data must be similarly positioned, exactly numbered, and exactly titled as shown for each format. Other data may be placed in unoccupied areas based upon the employer’s needs. Form identification may be placed before or after the core data. However, the employer’s non-core elements may be positioned only between the sections of core data.
Exhibit F
Form W-3
(Laser-Printed)

This form may be subject to change.

Form W-3 Transmittal of Wage and Tax Statements 2004

Signature

An Item To Note

Separate instructions. See the 2004 Instructions for Forms W-2 and W-3 for information on completing this form.

Purpose of Form

Use this form to transmit Copy A of Form(s) W-2, Wage and Tax Statement. Make a copy of Form W-3, and keep it with Copy D (For Employer) of Form(s) W-2 for your records. Use Form W-3 for the correct year. File Form W-3 even if only one Form W-2 is being filed. If you are filing Form(s) W-2 on magnetic media or electronically, do not file Form W-3.

When To File

File Form W-3 with Copy A of Form(s) W-2 by February 28, 2005.

Where To File

Send this entire page with the entire Copy A page of Form(s) W-2 to:

Social Security Administration
Data Operations Center
Wilkes-Barre, PA 18769-0001

Note: If you use "Certified Mail" to file, change the ZIP code to "18769-0002." If you use an IRS approved private delivery service, add "ATTN: W-2 Process, 1150 E. Mountain Dr. to the address and change the ZIP code to "18702-7997." See Circular E (Pub. 15), Employer's Tax Guide, for a list of IRS approved private delivery services.

Do not send magnetic media to the address shown above.

For Privacy Act and Paperwork Reduction Act Notice, see the back of Copy D of Form W-2.
26 CFR 1.601–105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.


**SECTION 1. PURPOSE**

This revenue procedure provides the domestic asset/liability percentages and domestic investment yields needed by foreign life insurance companies and foreign property and liability insurance companies to compute their minimum effectively connected net investment income under section 842(b) of the Internal Revenue Code for taxable years beginning after December 31, 2002. Instructions are provided for computing foreign insurance companies’ liabilities for the estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2002. For more specific guidance regarding the computation of the amount of net investment income to be included by a foreign insurance company on its U.S. income tax return, see Notice 89–96, 1989–2 C.B. 417. For the domestic asset/liability percentage and domestic investment yield, as well as instructions for computing foreign insurance companies’ liabilities for estimated tax and installment payments of estimated tax for taxable years beginning after December 31, 2001, see Rev. Proc. 2003–70, 2003–34 I.R.B. 406.

**SECTION 2. CHANGES**

.01 DOMESTIC ASSET/LIABILITY PERCENTAGES FOR 2003. The Secretary determines the domestic asset/liability percentage separately for life insurance companies and property and liability insurance companies. For the first taxable year beginning after December 31, 2002, the relevant domestic asset/liability percentages are:

- 125.9 percent for foreign life insurance companies, and
- 170.9 percent for foreign property and liability insurance companies.

.02 DOMESTIC INVESTMENT YIELDS FOR 2003. The Secretary is required to prescribe separate domestic investment yields for foreign life insurance companies and for foreign property and liability insurance companies. For the first taxable year beginning after December 31, 2002, the relevant domestic investment yields are:

- 6.8 percent for foreign life insurance companies, and
- 5.0 percent for foreign property and liability insurance companies.

.03 SOURCE OF DATA FOR 2003. The section 842(b) percentages to be used for the 2003 tax year are based on tax return data following the same methodology used for the 2002 year.

**SECTION 3. APPLICATION-ESTIMATED TAXES**

To compute estimated tax and the installment payments of estimated tax due for taxable years beginning after December 31, 2002, a foreign insurance company must compute its estimated tax payments by adding to its income other than net investment income the greater of (i) its net investment income as determined under section 842(b)(5), that is actually effectively connected with the conduct of a trade or business within the United States for the relevant period, or (ii) the minimum effectively connected net investment income under section 842(b) that would result from using the most recently available domestic asset/liability percentage and domestic investment yield. Thus, for installment payments due after the publication of this revenue procedure, the domestic asset/liability percentages and the domestic investment yields provided in this revenue procedure must be used to compute the minimum effectively connected net investment income. However, if the due date of an installment is less than 20 days after the date this revenue procedure is published in the Internal Revenue Bulletin, the asset/liability percentages and domestic investment yields provided in Rev. Proc. 2003–70 may be used to compute the minimum effectively connected net investment income for such installment. For further guidance in computing estimated tax, see Notice 89–96.

**SECTION 4. EFFECTIVE DATE**

This revenue procedure is effective for taxable years beginning after December 31, 2002.

**SECTION 5. DRAFTING INFORMATION**

The principal author of this revenue procedure is Garrett D. Gregory of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact Garrett D. Gregory at (202) 622–3870 (not a toll-free call), or write to the Internal Revenue Service, Office of the Associate Chief Counsel (International), 1111 Constitution Avenue, NW, Washington, DC 20224, Attention: CC:INTL:Br5, Room 4554.
Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

Deemed IRAs in Governmental Plans/Qualified Nonbank Trustee Rules

REG–101447–04

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations.

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9142) relating to qualification of governmental units as qualified nonbank trustees for deemed IRAs under section 408(q). The text of those regulations also serves as the text of these proposed regulations.

DATES: Written or electronic comments must be received by October 20, 2004.

ADDRESSES: The public may submit comments in three ways. Send submissions to: CC:PA:LPD:PR (REG–101447–04), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG–101447–04), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or send electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG–101447–04).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Linda L. Conway, (202) 622–6090; concerning submissions of comments, Treena Garrett, (202) 622–3401 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

The temporary regulations in this issue of the Bulletin amend 26 CFR part 1 relating to section 408(a). The temporary regulations set forth special rules for a governmental unit that maintains a plan qualified under section 401(a), 403(a), 403(b) or 457 to qualify as a nonbank trustee for deemed IRAs under section 408(q). The text of those regulations also serves as the text of these proposed regulations. The preamble of the temporary regulations explains the amendments and these proposed regulations.

Special Analyses

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

Proposed Amendments to the Regulations

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

PART 1 — INCOME TAXES

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

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

Par. 2. In § 1.408–2(e)(8)T is added to read as follows:

§1.408–2 - Special rules for governmental entities.

[The text of proposed §1.408–2 paragraph (e)(8) is the same as the text of §1.408–2(e)(8)T published elsewhere in this issue of the Bulletin].

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

(Filed by the Office of the Federal Register on July 21, 2004, 8:45 a.m., and published in the issue of the Federal Register for July 22, 2004, 69 F.R. 43786)
Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

Announcement 2004-63

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 before 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.

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 opportunity for a proceeding before an administrative law judge, the following individuals have been disbarred from practice before the Internal Revenue Service:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Designation</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banister, Joseph R.</td>
<td>San Jose, CA</td>
<td>CPA</td>
<td>June 25, 2004</td>
</tr>
</tbody>
</table>

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 suspension from practice before the Internal Revenue Service:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Designation</th>
<th>Effective Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stukes, Donald A.</td>
<td>Pound Ridge, NY</td>
<td>CPA</td>
<td>May 13, 2004 to May 11, 2005</td>
</tr>
<tr>
<td>Moore, Earl</td>
<td>Riverview, FL</td>
<td>CPA</td>
<td>March 26, 2004 to March 24, 2006</td>
</tr>
</tbody>
</table>
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 Professional 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:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Designation</th>
<th>Date of Suspension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bell, Don W.</td>
<td>Grand Junction, CO</td>
<td>Enrolled Agent</td>
<td>Indefinite from April 1, 2004</td>
</tr>
<tr>
<td>Lentz, Carole A.</td>
<td>Mastic, NY</td>
<td>Enrolled Agent</td>
<td>Indefinite from April 23, 2004</td>
</tr>
<tr>
<td>Cummiskey Jr., Edward R.</td>
<td>Warwick, NY</td>
<td>Enrolled Agent</td>
<td>Indefinite from April 23, 2004</td>
</tr>
<tr>
<td>Goble, Dennis R.</td>
<td>Valparaiso, IN</td>
<td>CPA</td>
<td>Indefinite from April 26, 2004</td>
</tr>
<tr>
<td>Grant, Elaine C.</td>
<td>Woodway, WA</td>
<td>Enrolled Agent</td>
<td>May 1, 2004 to October 31, 2004</td>
</tr>
<tr>
<td>Rivera, Eduardo M.</td>
<td>Torrence, CA</td>
<td>Attorney</td>
<td>May 1, 2004 to October 29, 2006</td>
</tr>
<tr>
<td>Masengale, Thomas J.</td>
<td>Indianapolis, IN</td>
<td>Enrolled Agent</td>
<td>Indefinite from May 1, 2004</td>
</tr>
<tr>
<td>Cohick, Jeffrey S.</td>
<td>Newville, PA</td>
<td>Enrolled Agent</td>
<td>May 1, 2004 to October 30, 2004</td>
</tr>
<tr>
<td>Bach, Royce E.</td>
<td>Deer Park, TX</td>
<td>Enrolled Agent</td>
<td>Indefinite from May 27, 2004</td>
</tr>
<tr>
<td>McMillin, Juanell</td>
<td>Austin, TX</td>
<td>Enrolled Agent</td>
<td>Indefinite from May 28, 2004</td>
</tr>
<tr>
<td>Silva, Hesmeregildo V.</td>
<td>Livermore, CA</td>
<td>Enrolled Agent</td>
<td>Indefinite from May 28, 2004</td>
</tr>
<tr>
<td>Grossman, Richard</td>
<td>Durham, NC</td>
<td>Attorney</td>
<td>Indefinite from June 1, 2004</td>
</tr>
<tr>
<td>Name</td>
<td>Address</td>
<td>Designation</td>
<td>Date of Suspension</td>
</tr>
<tr>
<td>--------------------</td>
<td>------------------</td>
<td>-------------</td>
<td>--------------------------</td>
</tr>
<tr>
<td>Schnieders, Joseph A.</td>
<td>St. Louis, MO</td>
<td>Enrolled Agent</td>
<td>Indefinite from June 1, 2004</td>
</tr>
<tr>
<td>Rahn, Miriam C.</td>
<td>Hutchinson, MN</td>
<td>Enrolled Agent</td>
<td>Indefinite from June 8, 2004</td>
</tr>
<tr>
<td>Tarantur, Dale B.</td>
<td>Glenview, IL</td>
<td>CPA</td>
<td>Indefinite from June 15, 2004</td>
</tr>
<tr>
<td>Derby, Mark</td>
<td>West Newton, MA</td>
<td>CPA</td>
<td>Indefinite from June 15, 2004</td>
</tr>
<tr>
<td>Miller, Winfred J.</td>
<td>Harrisonburg, VA</td>
<td>CPA</td>
<td>Indefinite from June 30, 2004</td>
</tr>
<tr>
<td>Croom, John A.</td>
<td>Austin, TX</td>
<td>CPA</td>
<td>Indefinite from July 1, 2004</td>
</tr>
<tr>
<td>Dion, Paul</td>
<td>Middletown, RI</td>
<td>CPA</td>
<td>Indefinite from July 8, 2004</td>
</tr>
<tr>
<td>Todd, Debra R.</td>
<td>Leander, TX</td>
<td>Enrolled Agent</td>
<td>Indefinite from August 30, 2004</td>
</tr>
</tbody>
</table>

**Expended 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:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Designation</th>
<th>Date of Suspension</th>
</tr>
</thead>
<tbody>
<tr>
<td>Somerville, Sally L.</td>
<td>Havre de Grace, MD</td>
<td>Attorney</td>
<td>Indefinite from May 3, 2004</td>
</tr>
<tr>
<td>Simon, Laurence M.</td>
<td>Englishtown, NJ</td>
<td>CPA</td>
<td>Indefinite from May 10, 2004</td>
</tr>
<tr>
<td>Taylor, Joelle T.</td>
<td>Carolina Beach, NC</td>
<td>CPA</td>
<td>Indefinite from May 10, 2004</td>
</tr>
</tbody>
</table>
Becker, Joseph C.  Austin, TX  CPA  Indefinite from May 10, 2004
Maffongelli Jr., Joseph  Montclair, NJ  Attorney  Indefinite from May 10, 2004
Lence, John A.  Kalispell, MT  CPA  Indefinite from May 21, 2004
McWade, Kenneth W.  Kaliua, HI  Attorney  Indefinite from June 9, 2004
Sims, William A.  Sausalito, CA  Attorney  Indefinite from June 9, 2004
Sommer, Peter J.  Baltimore, MD  Attorney  Indefinite from June 21, 2004
Eisenberg, Alan D.  Whitefish Bay, WI  Attorney  Indefinite from June 21, 2004
Litwin, Martin E.  Highland Park, IL  Attorney  Indefinite from June 21, 2004
Kiernat, Bruce E.  St. Paul, MN  Attorney  Indefinite from July 1, 2004

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 Internal 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:

<table>
<thead>
<tr>
<th>Name</th>
<th>Address</th>
<th>Date of Resignation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Murphy, Claire A.</td>
<td>Viera, FL</td>
<td>May 10, 2004</td>
</tr>
<tr>
<td>Murphy, John W.</td>
<td>Viera, FL</td>
<td>May 10, 2004</td>
</tr>
</tbody>
</table>
### Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent, or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

<table>
<thead>
<tr>
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<th>Address</th>
<th>Designation</th>
<th>Date of Censure</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clifton, Michael J.</td>
<td>Augusta, KS</td>
<td>CPA</td>
<td>May 12, 2004</td>
</tr>
<tr>
<td>Flaherty, Patrick J.</td>
<td>Traverse City, MI</td>
<td>CPA</td>
<td>May 19, 2004</td>
</tr>
<tr>
<td>Monroy, Frances</td>
<td>Petaluma, CA</td>
<td>Enrolled Agent</td>
<td>May 27, 2004</td>
</tr>
<tr>
<td>Pearson, Michael N.</td>
<td>Houston, TX</td>
<td>Enrolled Agent</td>
<td>June 7, 2004</td>
</tr>
</tbody>
</table>
Definition of Terms

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

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

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

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

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

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a previously published 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.—Acquisescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C—Individual.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
C.Y.—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.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
FR—Federal Register.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
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.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.F.F.—Transferfer.
T.F.R.—Transferer.
T.P.—Taxpayer.
TR—Trust.
TT—Trustee.
X—Corporation.
Y—Corporation.
Z—Corporation.
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