

HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

Rev. Rul. 2005-11, page 816.

Alternative minimum tax; refinanced mortgage interest. Interest paid on a home mortgage that has been refinanced more than one time is deductible as qualified housing interest for purposes of the alternative minimum tax to the extent the interest on the mortgage that was refinanced is qualified housing interest and the amount of the mortgage indebtedness is not increased.

Rev. Rul. 2005-17, page 823.

Frivolous tax returns; Social Security refund. This ruling emphasizes to taxpayers and to promoters and return preparers that there is no right to a refund of, or a deduction for, Social Security taxes paid based on arguments that a taxpayer has waived the right to receive Social Security benefits or has donated Social Security taxes or benefits to the government. These arguments have no merit and are frivolous.

Rev. Rul. 2005-18, page 817.

Frivolous tax returns; altering the jurat. This ruling deals with taxpayers who attempt to reduce their federal tax liability by striking or altering the written declaration (the jurat) that verifies that a return, declaration, statement or other document is made under penalties of perjury. The ruling emphasizes to taxpayers and to promoters and return preparers that striking or altering the jurat in a manner that negates its validity invalidates the return.

Rev. Rul. 2005-19, page 819.

Frivolous tax returns; constitutionally based arguments. This ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax by making frivolous constitutionally based arguments.

Rev. Rul. 2005-20, page 821.

Frivolous tax returns; protesting government programs or policies. This ruling emphasizes to taxpayers and to promoters and return preparers that liability for federal taxes does not depend on whether the taxpayer agrees with the government programs or policies that are funded with tax receipts. Any argument that taxpayers may refuse to report income or claim deductions because they oppose particular government programs or policies is frivolous and has no merit.

Rev. Rul. 2005-21, page 822.

Frivolous tax returns; use of "straw man" to avoid tax. This ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax on the erroneous theory that the government has created a separate and distinct entity or "straw man," in place of the taxpayer and that the taxpayer is not responsible for the tax obligations of the "straw man". This argument has no merit and is frivolous.

REG-163314-03, page 835.

Proposed regulations provide that a transaction will qualify for nonrecognition treatment under sections 332, 351, or 368 of the Code only if there is a transfer and a receipt of net value. The proposed regulations also provide guidance on the circumstances in which and the extent to which a creditor of an insolvent corporation may be treated as owning a proprietary interest in the target corporation for the purpose of satisfying the continuity of interest requirement. With respect to section 332, the regulations clarify that this section applies only to those cases in which the recipient corporation receives at least partial payment with respect to each class of stock which it owns in the liquidating corporation.

(Continued on the next page)

Finding Lists begin on page ii.



Department of the Treasury
Internal Revenue Service

Notice 2005–30, page 827.

This notice sets out some of the most common frivolous arguments and schemes that taxpayers use to avoid their tax obligations. It also identifies civil and criminal penalties that the Service may impose against taxpayers who engage in abusive tax-avoidance schemes. Notice 2004–22 modified and superseded.

Notice 2005–31, page 830.

State and local general sales tax deduction. This notice provides guidance to taxpayers who elect to deduct state and local general sales taxes in lieu of state and local income taxes under section 164(b)(5) of the Code.

EXEMPT ORGANIZATIONS

Announcement 2005–23, page 845.

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

EMPLOYMENT TAX

REG–160315–03, page 833.

Proposed regulations under section 3121 of the Code provide guidance regarding the treatment of payments made on account of sickness or accident disability under a workers' compensation law for purposes of the Federal Insurance Contributions Act (FICA).

EXCISE TAX

Rev. Proc. 2005–19, page 832.

The Service, as a matter of administrative convenience, has established that certain truck body type classifications satisfy the weight-based exclusion provided in section 4051(a)(2) of the Code.

TAX CONVENTIONS

Announcement 2005–22, page 826.

This agreement describes taxation of certain scholarships under the U.S.–Austria Income Tax Treaty. A copy of the News Release issued by the Director, International (U.S. Competent Authority), on March 1, 2005 (IR–2005–20), is set forth.

ADMINISTRATIVE

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Notice 2005–25, page 827.

Public comments are requested on recommendations for items that should be included on the 2005–2006 Guidance Priority List. Taxpayers may submit recommendations for guidance at any time during the year. Recommendations submitted by April 30, 2005, will be reviewed for possible inclusion on the original 2005–2006 Guidance Priority List. Recommendations received after April 30, 2005, will be reviewed for inclusion in the next periodic update.

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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:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

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

Section 55.—Alternative Minimum Tax Imposed

26 CFR 1.55-1: *Alternative minimum taxable income.*

Is interest paid on a home mortgage that has been refinanced more than one time deductible as qualified housing interest for purposes of the alternative minimum tax? See Rev. Rul. 2005-11, page 816.

Section 56.—Adjustments in Computing Alternative Minimum Taxable Income

(Also §§ 55, 163.)

Alternative minimum tax; refinanced mortgage interest. Interest paid on a home mortgage that has been refinanced more than one time is deductible as qualified housing interest for purposes of the alternative minimum tax to the extent the interest on the mortgage that was refinanced is qualified housing interest and the amount of the mortgage indebtedness is not increased.

Rev. Rul. 2005-11

ISSUE

Is interest paid on a home mortgage that has been refinanced more than one time deductible as qualified housing interest for purposes of the alternative minimum tax?

FACTS

In 1990, A borrowed \$100x to purchase a principal residence (the 1990 mortgage). In 2000, the outstanding principal balance on the 1990 mortgage was \$90x, and A refinanced the \$90x balance of the 1990 mortgage (the 2000 mortgage). In 2004, the outstanding principal balance on the 2000 mortgage was \$80x. A refinanced the \$80x balance of the 2000 mortgage and borrowed an additional \$30x. Thus, the total amount of A's mortgage in 2004 was \$110x (the 2004 mortgage). A did not use the \$30x to acquire, construct, or substantially improve any property that was a principal residence or a qualified residence. At no time did A's indebtedness to acquire his principal residence or a qualified residence

exceed \$1,000,000. A is not a married individual filing a separate return.

LAW AND ANALYSIS

Section 55 of the Internal Revenue Code provides that the alternative minimum tax is a tax equal to the excess (if any) of the tentative minimum tax for the taxable year over the regular tax (defined in § 55(c)) for the taxable year.

Tentative minimum tax is defined in § 55(b)(1)(A) for noncorporate taxpayers as the sum of 26 percent of so much of the taxable excess as does not exceed \$175,000, plus 28 percent of so much of the taxable excess as exceeds \$175,000.

The term "taxable excess" is defined in § 55(b)(1)(ii) as so much of the alternative minimum taxable income for the taxable year as exceeds the exemption amount provided for in § 55(d).

Alternative minimum taxable income is defined in § 55(b)(2) as the taxable income of the taxpayer for the taxable year determined with the adjustments provided in §§ 56 and 58, and increased by the amount of the items of tax preference described in § 57.

Section 56(b) contains the adjustments applicable to individuals, which include the adjustment for interest in § 56(b)(1)(C). Section 56(b)(1)(C) provides that, in determining the amount allowable as a deduction for interest, § 163(d), which provides limitations on investment interest, and § 163(h), which disallows deductions for personal interest, shall apply, except that in lieu of the exception under § 163(h)(2)(D) for qualified residence interest, the term "personal interest" shall not include any qualified housing interest.

Qualified housing interest is defined in § 56(e)(1) as interest that is qualified residence interest (as defined in § 163(h)(3)) and is paid or accrued during the taxable year on indebtedness that is incurred in acquiring, constructing, or substantially improving any property that is the principal residence (within the meaning of § 121) of the taxpayer at the time such interest accrues, or is a qualified dwelling that is a qualified residence (within the meaning of

§ 163(h)(4)). In addition, the last sentence of § 56(e)(1) provides that qualified housing interest includes interest on any indebtedness resulting from the refinancing of indebtedness meeting the requirements of qualified housing interest, but only to the extent that the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness immediately before the refinancing.

The legislative history to the enactment of § 56 as part of the Tax Reform Act of 1986 states "It is clarified that, for minimum tax purposes, upon a refinancing of a loan that gives rise to qualified housing interest, interest paid on the loan is treated as qualified housing interest to the extent that (1) it so qualified under the prior loan, and (2) the amount of the loan was not increased." H.R. Conf. Rep. No. 841, 99th Cong., 2d Sess., vol. II, at 259 (1986).

Section 163(h) of the Code provides that, in the case of a taxpayer other than a corporation, no deduction shall be allowed for personal interest paid or accrued during the taxable year. Under § 163(h)(2)(D), personal interest does not include qualified residence interest.

Qualified residence interest is defined in § 163(h)(3) as any interest that is paid or accrued during the taxable year on acquisition indebtedness or home equity indebtedness with respect to any qualified residence of the taxpayer. Section 163(h)(3)(B) defines acquisition indebtedness as any indebtedness that is incurred in acquiring, constructing, or substantially improving any qualified residence of the taxpayer and is secured by such residence. Section 163(h)(3)(B) also provides that acquisition indebtedness includes any indebtedness secured by such residence resulting from the refinancing of indebtedness meeting the requirements of acquisition indebtedness, or refinancing of acquisition indebtedness, but only to the extent the amount of the indebtedness resulting from such refinancing does not exceed the amount of the refinanced indebtedness. Under § 163(h)(3)(B)(ii), the aggregate amount of acquisition indebtedness for any period cannot exceed \$1,000,000 (or \$500,000 in the case of

a married individual filing a separate return).

The term “qualified residence” is defined in § 163(h)(4)(A) as the principal residence (within the meaning of § 121) of the taxpayer and one other residence of the taxpayer that is selected by the taxpayer for the taxable year and that is used by the taxpayer as a residence (within the meaning of § 280A(d)(1)).

The 1990 mortgage is indebtedness incurred in acquiring A’s principal residence. The interest paid or accrued on the 1990 mortgage meets the requirements of qualified residence interest under § 163(h)(3). Thus, the interest paid or accrued by A on the 1990 mortgage is qualified housing interest for purposes of the alternative minimum tax.

The last sentence of § 56(e)(1), as clarified by the legislative history, indicates that when § 56(b)(1)(C) was enacted as part of the alternative minimum tax provisions, Congress intended that interest with respect to a refinancing of a loan that gives rise to qualified housing interest would be deductible for alternative minimum tax purposes to the extent the amount of the loan was not increased. When A refinanced the 1990 mortgage in 2000, the refinanced amount equaled the amount of the outstanding principal. Thus, the interest paid or accrued on the 2000 mortgage is deductible as qualified housing interest for purposes of the alternative minimum tax because the interest on the 1990 mortgage is qualified housing interest and the amount of the loan is not increased.

Similarly, when A refinanced the 2000 mortgage in 2004, the interest on the 2004 mortgage is qualified housing interest to the extent of the outstanding principal balance of the 2000 mortgage at the time of the refinancing because the interest on the 2000 mortgage is qualified housing interest. However, as part of the 2004 refinancing A borrowed an additional \$30x, and A did not use the \$30x to acquire, construct, or substantially improve any property that was a principal residence or a qualified residence. Accordingly, for alternative minimum tax purposes A may deduct only the interest paid or incurred on \$80x and not the interest attributable to the additional \$30x of the \$110x of the 2004 mortgage.

HOLDING

Interest paid on a home mortgage that has been refinanced more than one time is deductible as qualified housing interest for purposes of the alternative minimum tax to the extent the interest on the mortgage that was refinanced is qualified housing interest and the amount of the mortgage indebtedness is not increased.

DRAFTING INFORMATION

The principal author of this revenue ruling is Martin Scully, Jr. of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this revenue ruling, contact Mr. Scully at (202) 622-4960 (not a toll-free call).

Section 163.—Interest

26 CFR 1.163-10T: Qualified residence interest (temporary).

Is interest paid on a home mortgage that has been refinanced more than one time deductible as qualified housing interest for purposes of the alternative minimum tax? See Rev. Rul. 2005-11, page 816.

Section 6065.—Verification of Returns

(Also Section 6702.)

Frivolous tax returns; altering the jurat. This ruling deals with taxpayers who attempt to reduce their federal tax liability by striking or altering the written declaration (the jurat) that verifies that a return, declaration, statement or other document is made under penalties of perjury. The ruling emphasizes to taxpayers and to promoters and return preparers that striking or altering the jurat in a manner that negates its validity invalidates the return.

Rev. Rul. 2005-18

PURPOSE

The Service is aware that some taxpayers are attempting to reduce their federal tax liability by striking or otherwise invalidating the written declaration (the jurat) that verifies that a return, declaration,

statement, or other document is made under penalties of perjury as required by section 6065. The Service also is aware that some promoters, including return preparers, are advising or recommending that taxpayers take frivolous positions, which include striking or otherwise invalidating the jurat. Some promoters market a package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on these and other meritless arguments.

This revenue ruling emphasizes to taxpayers and to promoters and return preparers that striking or otherwise altering the jurat in a manner that negates or casts doubt on its validity invalidates the return. Any argument that the law does not require written verification of the accuracy of the return has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their federal tax obligations by taking frivolous positions, including frivolous positions based on arguments relating to an altered or amended jurat. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the Service are processed through the Service’s Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether an injunction should be sought to halt these activities. Other information about frivolous tax positions is available on the Service website at www.irs.gov.

ISSUE

Whether a document, declaration, or statement that is required to be verified under penalties of perjury, pursuant to section 6065, is valid if the jurat has been stricken or otherwise altered in a manner

that negates or casts doubt on validity of the return?

FACTS

Situation 1. Individual taxpayer A filed a Form 1040A individual income tax return for the 2004 taxable year. Taxpayer A signed the form but crossed out the jurat on the return, and wrote the word “void” across it.

Situation 2. Individual taxpayer B filed a Form 1040A individual income tax return for the 2004 taxable year. Taxpayer B signed the Form 1040A without deleting or altering the jurat, but wrote across the top of the Form 1040A that “I deny that I owe the tax shown on this return.”

LAW AND ANALYSIS

Section 6011(a) requires any person liable for taxes to file a return that includes “the information required by [the] forms or regulations” issued by the Service. *See also* Treas. Reg. sec. 1.6012-1(a)(6) (prescribing Form 1040 for making an income tax return). Section 6065 mandates that any return, declaration, statement, or other document required under the internal revenue laws and regulations “contain or be verified by a written declaration that it is made under the penalties of perjury.” For taxpayer convenience, paper returns all contain a pre-printed written declaration or jurat.

It is well settled that if a taxpayer strikes or obliterates the jurat on a tax return or other document, the jurat is void, as is the underlying return, because the return no longer meets the requirements of section 6011(a) and section 6065. *See Lucas v. Pilliod Lumber Co.*, 281 U.S. 245, 248 (1930) (a return that was not properly verified under oath by the corporate officers did not meet the requirements of 6011(a) and section 6065); *Borgeson v. United States*, 757 F.2d 1071, 1072-73 (10th Cir. 1985) (the plain wording of section 6065 requires the jurat on any return); *United States v. Moore*, 627 F.2d 830, 834 (7th Cir. 1980) (the forms submitted by the taxpayer were not returns because the jurat was obliterated); *Cupp v. Commissioner*, 65 T.C. 68, 78-79 (1975) (documents submitted by the taxpayer that were not signed under penalty of perjury were not returns), *aff'd without published opinion*, 559 F.2d 1207 (3d Cir. 1977).

If the taxpayer adds language to the jurat, or adds language to the return that casts doubt on the validity of the jurat, courts look to the intent and effect of the change in order to determine the validity of the underlying return. A change that negates or casts doubt on the validity of the jurat, or the taxpayer’s intent to affirm the contents of the return under penalty of perjury, will void the jurat. *See Williams v. Commissioner*, 114 T.C. 136, 140-41 (2000) (language added by the taxpayer above the jurat box that denied liability for the tax reported on the return still had the effect of vitiating the verification); *Sloan v. Commissioner*, 102 T.C. 137, 141-47 (1994) (language added within the jurat box that “[raised] serious questions about whether petitioner [was] ‘denying’ the accuracy of the information contained in the return, ‘disclaiming’ the jurat altogether, or simply protesting the tax laws,” ultimately acted to invalidate the return), *aff'd*, 53 F.3d 799 (7th Cir. 1995). If there is any doubt whether an addition or alteration to the jurat is intended to negate or deny the jurat, the Service is “entitled to construe alterations of the jurat against the taxpayer...” *Sloan v. Commissioner*, 53 F.3d 799, 800 (7th Cir. 1995).

There is no authority under any U.S. law that supports the position that individuals may avoid their income tax obligations by striking or otherwise modifying the jurat in a manner that casts doubt on its validity. Moreover, tampering with the form of a tax return, including the jurat, substantially impedes the Service’s ability to process and verify the return. *Beard v. Commissioner*, 82 T.C. 766, 776-777 (1984), *aff'd*, 793 F.2d 139 (6th Cir. 1986). Courts routinely impose monetary penalties on taxpayers who cite constitutional and other frivolous arguments as a basis for striking or modifying the jurat. *See Borgeson*, 757 F.2d at 1073 (upholding imposition of frivolous return penalty under section 6702); *Trowbridge v. Commissioner*, T.C. Memo. 2003-165, *aff'd*, 378 F.3d 432 (5th Cir. 2004).

In Situation 1, taxpayer A rendered the Form 1040A void by crossing out the jurat and writing “void” across it. In Situation 2, taxpayer B rendered the Form 1040A void by adding language to the Form 1040A that casts doubt on the validity of the jurat. This action represents a failure on the part

of taxpayer B to verify the accuracy and truthfulness of the Form 1040A.

CIVIL AND CRIMINAL PENALTIES

The Service will challenge the claims of individuals who attempt to avoid or evade their federal tax liability. In addition to liability for the tax due plus statutory interest, taxpayers who fail to file valid returns or pay tax based on an argument that they can alter or amend the jurat on a return face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) a \$500 penalty imposed under section 6702 when the taxpayer files a document that purports to be a return but that contains a frivolous position or suggests a desire by the taxpayer to delay or impede the administration of Federal income tax laws; (2) the section 6651 additions to tax for failure to file a return, failure to pay the tax owed, and fraudulent failure to file a return; and (3) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on these frivolous positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; and (2) willful failure to file a return under section 7203, for which the penalty is a significant fine and imprisonment for up to a year.

Persons, including return preparers, who promote these frivolous positions and those who assist taxpayers in claiming tax benefits based on these frivolous positions may face civil and criminal penalties and also may be enjoined by a court pursuant to sections 7407 and 7408. Potential penalties include: (1) a penalty under section 6700 for promoting abusive tax shelters; (2) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (3) criminal prosecution under section 7206, for which the penalty is a fine of up to \$100,000 and imprisonment for up to 3 years, for assisting or advising about the preparation of a false return or other document under the internal revenue laws.

HOLDING

The law mandates that any return, declaration, statement, or other document re-

quired under the internal revenue laws and regulations contain a valid jurat. The claim that taxpayers can reduce their federal tax liability by striking or amending the jurat on a return, declaration, statement, or other document is frivolous.

DRAFTING INFORMATION

The principal author of this revenue ruling is the Office of the Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office at (202) 622-7950 (not a toll-free call).

Section 6651.—Failure to File Tax Return or to Pay Tax

(Also Sections 6662, 6663, 6673, 6702, 7201, 7203, 7206, and 7408.)

Frivolous tax returns; constitutionally based arguments. This ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax by making frivolous constitutionally based arguments.

Rev. Rul. 2005-19

PURPOSE

The Service is aware that some taxpayers are attempting to reduce their federal tax liability by claiming that the federal income tax is unlawful because it violates one or more provisions of the United States Constitution, or that they have a constitutional right not to comply with the federal tax laws. The Service is also aware that promoters, including return preparers, are advising or recommending that taxpayers take frivolous positions based on these arguments. Some promoters market a package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on these and other meritless arguments.

This revenue ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax by making frivolous constitutionally based arguments.

The Service is committed to identifying individuals who attempt to avoid

or evade their federal tax obligations by taking frivolous positions, including frivolous constitutional positions. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt these activities. Other information about frivolous tax positions is available on the Service website at www.irs.gov.

ISSUES

1. Whether a taxpayer may refuse to file a federal income tax return, or to pay federal income tax, based on claims that the federal income tax is unconstitutional?

2. Whether a taxpayer may refuse to file a federal income tax return based on the claim that the requirement to do so violates the prohibition against self-incrimination contained in the Fifth Amendment to the U.S. Constitution?

FACTS

1. Taxpayer A is a United States citizen who resides in state X. A attended seminars on the federal tax system sponsored by S, an attorney. S made claims at these seminars that the federal income tax is unconstitutional because: (a) the Sixteenth Amendment to the U.S. Constitution, which authorizes a federal income tax, was not properly ratified by the states; (b) the federal income tax violates the due process clause of the Fifth Amendment to the U.S. Constitution; and (c) the payment of taxes is a form of involuntary servitude or slavery prohibited by the Thirteenth Amendment to the U.S. Constitution. Based on these constitu-

tionally-based positions promoted by S, A filed a Form W-4, *Employee's Withholding Allowance Certificate*, with A's employer that claimed excess exemptions so that little or no federal income tax would be withheld from A's wages in 2004. Taxpayer A earned \$40,000 of taxable income in 2004. Relying on these constitutionally-based positions promoted by S, A did not file a federal income tax return for 2004.

2. Taxpayer B is a United States citizen who earned \$40,000 in taxable income in 2004. On B's 2004 Form 1040, federal income tax return, B wrote "Fifth Amendment privilege" on each line and did not report any taxable income for the year.

LAW AND ANALYSIS

The Sixteenth Amendment provides that Congress shall have the power to lay and collect taxes on income, from whatever source derived, without apportionment among the several states and without regard to any census or enumeration. U.S. CONST. amend. XVI. The United States Supreme Court has upheld the constitutionality of the income tax laws enacted subsequent to ratification of the Sixteenth Amendment. *See, e.g., Brushaber v. Union Pac. R.R. Co.*, 240 U.S. 1 (1916) (relying on the Sixteenth Amendment in holding that the income tax provisions of the Tariff Act of 1913 were not unconstitutional).

Promoters who claim that the federal income tax is unconstitutional often make frivolous arguments that there were defects in the ratification of the Sixteenth Amendment by the states. There are a number of variations on these frivolous arguments: (i) versions of the Amendment ratified by the states contained defects in spelling, punctuation, wording, or capitalization; (ii) state legislatures did not follow proper procedures in ratifying the amendment; (iii) state governors did not sign the amendment; (iv) one or more of the states that ratified the Amendment was not legally a state; and (v) the Amendment does not contain an enabling clause. These arguments have no merit, and courts have consistently rejected all challenges to the constitutionality of the federal income tax following enactment of the Sixteenth Amendment. *See Knoblauch v. Commissioner*, 749 F.2d 200, 201 (5th

Cir. 1984) (“Every court that has considered this argument has rejected it.”). Arguments to the contrary are frivolous.

The Fifth Amendment prevents the federal government from taking property without due process of law. U.S. CONST. amend. V. Due process generally includes a right to notice and an opportunity to be heard. The Supreme Court has held that the procedures contained in the Internal Revenue Code fully satisfy the due process rights of taxpayers. See *Phillips v. Commissioner*, 283 U.S. 589, 595–99 (1931) (“The right of the United States to collect its internal revenue by summary administrative proceedings has long been settled. Where, as here, adequate opportunity is afforded for a later judicial determination of the legal rights, summary proceedings to secure prompt performance of pecuniary obligations to the government have been consistently sustained.”). The argument that due process requires a hearing before tax has to be paid or can be withheld from wages is frivolous.

The federal income tax only requires payment of taxes on a person’s income. It does not force a person to labor involuntarily, or to labor at all. The Thirteenth Amendment prohibits slavery and involuntary servitude, except as punishment when convicted of a crime. U.S. CONST. amend. XIII. The Thirteenth Amendment does not proscribe taxation. See *Abney v. Campbell*, 206 F.2d 836, 841 (5th Cir. 1953) (The specification, that the act violates the Thirteenth Amendment by imposing involuntary servitude upon an employer of domestic servants, seems to us far-fetched, indeed frivolous.”). Moreover, a prison sentence for failing to file a federal income tax return is not prohibited by the Thirteenth Amendment. See *United States v. Drefke*, 707 F.2d 978, 983 (8th Cir. 1983) (“The Thirteenth Amendment, however, is inapplicable where involuntary servitude is imposed as punishment for a crime.”). Failing to file a federal income tax return or to pay federal income tax based on the argument that it would constitute involuntary servitude is frivolous.

The Fifth Amendment provides that in a criminal case a person may not be compelled to be a witness against himself. U.S. CONST. amend. V. This generally means that a person cannot be forced to answer a question if the answer will be used against

that person in a criminal prosecution. Courts have routinely held, however, that the Fifth Amendment provides no basis for failing or refusing to file a tax return. *United States v. Stillhammer*, 706 F.2d 1072, 1076–77 (10th Cir.1983) (“[T]he Fifth Amendment does not serve as a defense for failing to make any tax return, and a return containing no information but a general objection based on the Fifth Amendment does not constitute a return as required by the Code.”). The remote possibility that a taxpayer’s statement on a tax return might be used as evidence in a future criminal prosecution will not relieve a taxpayer from the obligation to file a tax return and properly report income and pay tax due. See *California v. Byers*, 402 U.S. 424, 427–29 (1971) (“[T]he remote possibility of incrimination is insufficient to defeat strong policies of disclosure called for by” government regulatory scheme.). Additionally, involvement in illegal activities will not relieve a person of the duty to file a federal income tax return because income earned from illegal activities is subject to the federal income tax. *United States v. Sullivan*, 274 U.S. 259, 263–64 (1927) (“It would be an extreme if not an extravagant application of the Fifth Amendment to say that it authorized a man to refuse to state the amount of his income because it had been made in crime.”).

CIVIL AND CRIMINAL PENALTIES

In determining the correct amount of tax due, the Service will include income that taxpayers attempt to exclude based on frivolous constitutional arguments. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on these and other frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6651 additions to tax for failure to file a return, failure to pay the tax owed, and fraudulent failure to file a return; (2) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (3) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (4) a \$500 penalty under section 6702 for filing a frivolous return; and (5) a penalty of up to \$25,000 under section 6673 if the

taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on these positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; (2) willful failure to make a return or pay tax under section 7203, for which the penalty is a significant fine and imprisonment of up to 1 year; or (3) making false statements on a return under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years.

Persons, including return preparers, who promote these frivolous positions and those who assist taxpayers in claiming tax benefits based on these frivolous arguments may face penalties and may be enjoined by a court pursuant to sections 7407 and 7408. Potential penalties include: (1) a \$250 penalty under section 6694 for each return prepared by an income tax preparer who knew or should have known that the taxpayer’s argument was frivolous (or \$1,000 for each return if the return preparer’s actions were willful, intentional or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years for assisting or advising about the preparation of a false return or other document under the internal revenue laws.

HOLDINGS

1. The Sixteenth Amendment to the U.S. Constitution was properly ratified and authorizes the federal income tax. Filing a federal income tax return and paying federal income tax does not constitute the taking of property without due process of law under the Fifth Amendment to the U.S. Constitution. Filing a federal income tax return, paying federal income tax, and incarceration for failure to comply with federal income tax obligations is not involuntary servitude or slavery prohibited by the Thirteenth Amendment to the U.S. Constitution. Arguments to the contrary are frivolous.

2. A taxpayer may not properly refuse to file a federal income tax return based on the claim that the requirement to do so violates the prohibition against self-incrimination of the Fifth Amendment to the U.S. Constitution. Arguments to the contrary are frivolous.

DRAFTING INFORMATION

This revenue ruling was drafted by the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office at (202) 622-7950 (not a toll-free call).

(Also Sections 6662-6664, 6702.)

Frivolous tax returns; protesting government programs or policies. This ruling emphasizes to taxpayers and to promoters and return preparers that liability for federal taxes does not depend on whether the taxpayer agrees with the government programs or policies that are funded with tax receipts. Any argument that taxpayers may refuse to report income or claim deductions because they oppose particular government programs or policies is frivolous and has no merit.

Rev. Rul. 2005-20

PURPOSE

The Service is aware that some taxpayers are attempting to reduce or eliminate their federal tax liability by taking the position that they are not required to pay taxes if those taxes might be used to support government programs or policies with which they disagree. Common examples include moral, ethical, or religious opposition to government spending for weapons programs, military operations, or medical research. The Service is also aware that promoters, including return preparers, are advising or recommending that taxpayers take frivolous positions based on these arguments. Some promoters market a package, kit, or other materials that claim to show taxpayers how they can avoid paying taxes based on these and other meritless arguments.

This revenue ruling emphasizes to taxpayers and to promoters and return pre-

parers that liability for federal taxes does not depend on whether the taxpayer agrees with the government programs or policies that are funded with tax receipts. Any argument that taxpayers may refuse to report income or claim deductions because they oppose particular government programs or policies is frivolous and has no merit.

The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by taking frivolous positions, including frivolous positions based on opposition to government programs or policies. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt these activities. Other information about frivolous tax positions is available on the Service website at www.irs.gov.

ISSUE

Whether a taxpayer's disagreement with government programs or policies on moral, ethical, religious or other grounds allows the taxpayer to refuse to file federal tax returns or to refuse to pay part or all of the taxpayer's federal tax liability?

LAW AND ANALYSIS

Section 1 of the Internal Revenue Code imposes a tax on all taxable income. There is no authority under the Internal Revenue Code or any other applicable law that allows taxpayers to refuse to file tax returns because they do not agree with government programs or policies. Further, it is well settled that deductions and credits are a matter of legislative grace and are not allowed unless specifically provided for in

the Internal Revenue Code. *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992). There is no provision in the Internal Revenue Code that permits taxpayers to file returns claiming deductions or credits that reduce their taxable income by the percentage they estimate the government spends on programs or policies with which they disagree.

These frivolous positions are variations of arguments taxpayers have made about religion and taxation that have been repeatedly rejected by the courts. In *United States v. Lee*, 455 U.S. 252 (1982), a member of a religious denomination claimed that the payment of social security taxes violated his First Amendment right to free exercise of religion. The United States Supreme Court rejected this argument, stating that "the tax system could not function if denominations were allowed to challenge the tax system because tax payments were spent in a manner that violates their religious belief." *Id.* at 260. The Court held that religious or moral beliefs that conflict with the payment of tax provide no basis for resisting the tax. *Id.*

Courts repeatedly have rejected these and similar arguments that a taxpayer's religious or moral beliefs permit the avoidance of federal taxes, and have imposed penalties against taxpayers who make these arguments. *See Schehl v. Commissioner*, 855 F.2d 364, 367 (6th Cir. 1988) ("Alleged vocal opposition to taxes for a particular reason, and refusal to pay taxes, even if all assertions were taken as true . . . are simply not a basis to challenge an assessment of taxes."); *Nelson v. United States*, 796 F.2d 164 (6th Cir. 1986) (upholding the applicability and constitutionality of a frivolous return penalty imposed against a taxpayer who claimed a deduction based on religious objection to war expenditures); *Randall v. Commissioner*, 733 F.2d 1565, 1567 (11th Cir. 1984) ("[A]rguments involving objections to the Government's military expenditures as a basis for non-payment of taxes have been raised by taxpayers many times, and in each instance the courts have rejected them.").

CIVIL AND CRIMINAL PENALTIES

The Service will disallow deductions or other claimed tax benefits, including the exclusion of income, based on frivolous ar-

guments regarding opposition to government programs or expenditures. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on these and other frivolous arguments may face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (2) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (3) a \$500 penalty under section 6702 for filing a frivolous return; and (4) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on these frivolous positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; or (2) making false statements on a return under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years.

Persons who promote these frivolous positions and those who assist taxpayers in claiming tax benefits based on these positions may be enjoined by a court pursuant to sections 7407 and 7408 and also may face potential civil and criminal penalties. Potential penalties include: (1) a \$250 penalty under section 6694 for each return prepared by an income tax return preparer who knew or should have known that the taxpayer's argument was frivolous (or \$1,000 for each return if the return preparer's actions were willful, intentional, or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years, for assisting or advising about the preparation of a false return or other document under the internal revenue laws.

HOLDING

Taxpayers may not refuse to file tax returns and may not claim deductions or credits on their tax returns based on their opposition to government programs or

policies. Any claim that individuals may reduce their federal tax liability based on objections to the use of the taxes to support government programs or policies is frivolous and has no merit.

DRAFTING INFORMATION

The principal author of this revenue ruling is the Office of the Associate Chief Counsel (Procedure & Administration) Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office at (202) 622-7950 (not a toll-free call).

Section 6662.—Imposition of Accuracy-Related Penalty on Underpayments

(Also Section 6664.)

Frivolous tax returns; use of “straw man” to avoid tax. This ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax on the erroneous theory that the government has created a separate and distinct entity or “straw man,” in place of the taxpayer and that the taxpayer is not responsible for the tax obligations of the “straw man”. This argument has no merit and is frivolous.

Rev. Rul. 2005-21

PURPOSE

The Service is aware that some taxpayers are attempting to reduce their federal tax liability by taking the incorrect position that their incomes are not subject to tax based on a theory that the government has created a separate and distinct entity, or “straw man,” in place of the taxpayer and that the taxpayer is not responsible for the tax obligations of the “straw man.” Some promoters market a package, kit, or other materials that claim to show taxpayers how they can avoid paying income taxes based on these and other meritless arguments.

This revenue ruling emphasizes to taxpayers and to promoters and return preparers that a taxpayer cannot avoid income tax on the erroneous theory that the government has created a “straw man.” This argument has no merit and is frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by taking frivolous positions, including frivolous positions based on meritless “straw man” or similar arguments. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers, promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt these activities. Other information about frivolous tax positions is available on the Service website at www.irs.gov.

ISSUE

Whether the government's use of different forms of a taxpayer's name (e.g., different capitalization formats, spellings) creates a “straw man,” which is a separate and distinct legal entity from the taxpayer to allow the taxpayer to avoid federal tax obligations?

DISCUSSION OF THE “STRAW MAN” CLAIM

The “straw man” claim is premised on the erroneous theory that most government documents do not actually refer to individuals. Users of the “straw man” theory falsely claim that only documents using an individual's name with “standard” capitalization, *i.e.*, lower-case with only the beginning letters of each name capitalized, are legitimate. These individuals erroneously argue that the use of the individual's name in all upper-case letters, which is common in some government documents, refers to a separate legal entity, called a “straw man.” These individuals also erroneously argue that, as a result of the creation of a “straw man,”

they are not liable for the debts, including the tax debts, of their “straw man,” that taxing the “straw man” is illegal because the “straw man” is a debt instrument based upon the labor of a real person and is, therefore, a form of slavery, or that no tax is owed by the real individual because it can be satisfied, or offset, by money in a “Treasury Direct Account” held in the name of the “straw man.”

All individuals are subject to the provisions of the Internal Revenue Code. Section 1 imposes a tax on all taxable income. Section 61 provides that gross income includes all income from whatever source derived, including compensation for services. Adjustments to income, deductions, and credits must be claimed in accordance with the provisions of the Internal Revenue Code, the accompanying Treasury regulations, and other applicable federal law. Section 6011 provides that any person liable for any tax imposed by the Internal Revenue Code shall make a return when required by Treasury regulations, and that returns must be filed in accordance with Treasury regulations and IRS forms. Section 6012 identifies the persons who are required to file income tax returns. Section 6151 requires that taxpayers pay their tax when the return is due. Section 6311 requires payment of taxes by commercially acceptable means as prescribed by Treasury regulations.

There is no authority under the Internal Revenue Code or any other applicable law that supports the claim that taxpayers may avoid their federal tax obligations based on “straw man” arguments, as described in this revenue ruling, or on similar arguments. The formatting of a taxpayer’s name in all upper-case letters on government documents or elsewhere has no significance whatsoever for federal tax purposes. Courts have rejected as frivolous “straw man” arguments. *United States v. Furman*, 168 F.Supp.2d 609 (E.D. La. 2001) (rejecting criminal defendant’s contention that he was not properly identified in federal government documents that misspelled his name or used his properly spelled name in all capital letters). In addition, courts repeatedly have rejected similar arguments based on frivolous claims that purport to provide a basis for avoiding taxes, and have penalized taxpayers who have made these arguments. *See, e.g., Lovell v. United States*, 755 F.2d 517, 519

(7th Cir. 1984) (“[A]ll individuals, natural or unnatural, must pay federal income tax on their wages”); *United States v. Romero*, 640 F.2d 1014, 1017 (9th Cir. 1981) (“[I]n our system of government, one is free to speak out in open opposition to the provisions of the tax laws, but such opposition does not relieve a citizen of his obligation to pay taxes.”).

CIVIL AND CRIMINAL PENALTIES

The Service will challenge the claims of individuals who attempt to avoid or evade their federal tax liability by refusing to file returns and pay tax, and will disallow deductions or other claimed tax benefits, including the exclusion of income, based on frivolous “straw man” arguments. In addition to liability for the tax due plus statutory interest, individuals who claim tax benefits on their returns, or fail to file returns, based on these and other frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include: (1) the section 6651 additions to tax for failure to file a return, failure to pay the tax owed, and fraudulent failure to file a return; (2) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (3) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (4) a \$500 penalty under section 6702 for filing a frivolous return; and (5) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on these theories also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which there is a significant fine and imprisonment for up to 5 years; (2) willful failure to file a return under section 7203, for which there is a significant fine and imprisonment for up to one year; or (3) making false statements on a return, statement, or other document under section 7206, for which there is a significant fine and imprisonment for up to 3 years.

Persons, including return preparers, who promote these theories and those who assist taxpayers in claiming tax benefits based on these frivolous arguments may face penalties and also may be enjoined by courts pursuant to sections 7407 and

7408. Potential penalties include: (1) a \$250 penalty under section 6694 for each return or claim for refund prepared by an income tax return preparer who knew or should have known that the taxpayer’s argument was frivolous (or \$1,000 for each return or claim for refund if the return preparer’s actions were willful, intentional or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which there is a significant fine and imprisonment for up to 3 years for assisting or advising about the preparation of a false return, statement or other document under the internal revenue laws.

HOLDING

The use of different forms of a taxpayer’s name (different spellings, capitalization, etc.) does not create a “straw man” that allows taxpayers to avoid their federal tax obligations. Claims based on “straw man” arguments or on similar arguments, to avoid federal tax obligations, are frivolous and have no merit.

DRAFTING INFORMATION

The author of this ruling is the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this ruling, contact that office at (202) 622-7950 (not a toll-free call).

Section 6673.—Sanctions and Costs Awarded by Courts

(Also Sections 6662, 6663, and 6702.)

Frivolous tax returns; Social Security refund. This ruling emphasizes to taxpayers and to promoters and return preparers that there is no right to a refund of, or a deduction for, Social Security taxes paid based on arguments that a taxpayer has waived the right to receive Social Security benefits or has donated Social Security taxes or benefits to the government. These arguments have no merit and are frivolous.

Rev. Rul. 2005-17

PURPOSE

The Service is aware that some taxpayers are filing claims for refund of the Social Security taxes paid on wages pursuant to the Federal Insurance Contributions Act (FICA) on the basis that they have waived their right to receive Social Security benefits. The Service also is aware that some taxpayers are attempting to reduce or eliminate their federal tax liability by taking similar frivolous return positions, including reporting as a charitable contribution deduction the amount of Social Security taxes paid, on the basis that they are donating these amounts to the government. Some promoters market a package, kit, or other materials, that claim to show taxpayers how they can obtain a refund or avoid paying income taxes based on these and other meritless arguments. This revenue ruling does not apply to individuals who have satisfied the requirements of the religious exemption from FICA provided in section 3127 of the Internal Revenue Code.

This revenue ruling emphasizes to taxpayers and to promoters and return preparers that there is no right to a refund of, or a deduction for, Social Security taxes paid based on arguments that a taxpayer has waived the right to receive Social Security benefits or has donated Social Security taxes or benefits to the government. These arguments have no merit and are frivolous.

The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by taking frivolous positions, including frivolous positions based on arguments regarding waiver of Social Security benefits. The Service will take vigorous enforcement action against these taxpayers and against promoters and return preparers who assist taxpayers in taking these frivolous positions. Frivolous returns and other similar documents submitted to the Service are processed through its Frivolous Return Program. As part of this program, the Service confirms whether taxpayers who take frivolous positions have filed all of their required tax returns, computes the correct amount of tax and interest due, and determines whether civil and criminal penalties should apply. The Service also determines whether civil or criminal penalties should apply to return preparers,

promoters, and others who assist taxpayers in taking frivolous positions, and recommends whether a court injunction should be sought to halt these activities. Other information about frivolous tax positions is available on the Service's website at www.irs.gov.

ISSUES

1. Whether taxpayers are entitled to a refund of Social Security taxes paid on the theory that they have waived the right to receive Social Security benefits?

2. Whether taxpayers are entitled to a charitable contribution deduction for Social Security taxes paid on the theory that those amounts have been donated by them to the government?

FACTS

This plan includes claims for refund of Social Security taxes paid on wages under FICA, on the theory that the taxpayer has waived the right to receive Social Security benefits. Additionally, some taxpayers claim a charitable contribution deduction on the theory that they have donated their Social Security taxes, or their right to receive Social Security benefits, to the government.

LAW AND ANALYSIS

Social Security taxes are imposed on wages as defined in section 3121. There is no authority under the Internal Revenue Code (other than the narrow exception to the application of FICA tax provided in the religious exemption under section 3127) or any other applicable law that supports the claim that taxpayers may waive their right to receive Social Security benefits and thereby receive a refund of Social Security taxes paid. Similarly, there is no provision of law that would allow a taxpayer to claim a charitable contribution deduction as a result of the donation or gift to the government of the taxpayer's right to receive Social Security benefits or of Social Security taxes paid.

In *Crouch v. Commissioner*, T.C. Memo. 1990-309, the taxpayers did not pay self-employment tax based on a claim that they had withdrawn from the Social Security system. The taxpayers also claimed a charitable contribution deduction based on a purported lump-sum gift

to the government of Social Security benefits. The Tax Court rejected these positions, characterizing the taxpayers' failure to pay self-employment tax as negligent and sustaining the Service's disallowance of the charitable contribution deduction. See also *Derksen v. Commissioner*, 84 T.C. 355, 360 (1985) ("There are some specific exemptions from the [social security] tax but the desire not to be a part of the social security system, standing alone, is not one of them.")

A refund claim must be based on a valid argument that the taxpayer has overpaid the tax that is lawfully due and owing. See, e.g., *Lewis v. Reynolds*, 284 U.S. 281, 283 (1932) ("[T]he taxpayer is not entitled to a refund unless he has overpaid his tax."). Further, it is a well settled principle of law that deductions and credits are a matter of legislative grace. See *INDOPCO, Inc. v. Commissioner*, 503 U.S. 79, 84 (1992); *New Colonial Ice Co. v. Helvering*, 292 U.S. 435, 440 (1934). Unless specifically provided for in the Internal Revenue Code, no deduction or credit is allowed. Neither section 3121, nor any other provision of the Internal Revenue Code, allows for a refund of Social Security taxes paid on the grounds that a taxpayer has purportedly waived all rights to receive Social Security benefits. Similarly, no provision of the Internal Revenue Code allows for a charitable contribution deduction based on the purported gift or donation of Social Security taxes or benefits to the government.

CIVIL AND CRIMINAL PENALTIES

The Service will disallow any claim for refund of Social Security taxes based on the frivolous argument that a taxpayer has waived the right to receive Social Security benefits. The Service will also disallow any deduction that is based on the theory that a taxpayer has given or donated the taxpayer's Social Security taxes or Social Security benefits to the government. In addition to liability for tax due plus statutory interest, individuals who claim tax benefits on their returns based on these and similar frivolous arguments face substantial civil and criminal penalties. Potentially applicable civil penalties include, but are not limited to the following: (1) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (2)

the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (3) a \$500 penalty under section 6702 for filing a frivolous income tax return; and (4) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers relying on these frivolous positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; or (2) making false statements on a return, statement, or other document under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years.

Persons, including return preparers, who promote these frivolous positions and those who assist taxpayers in claiming tax benefits based on these frivolous positions also may face penalties and may be enjoined by a court pursuant to sections 7407

and 7408. Potential penalties include: (1) a \$250 penalty under section 6694 for each return or claim for refund prepared by an income tax return preparer who knew or should have known that the taxpayer's position was frivolous (or \$1,000 for each return or claim for refund if the return preparer's actions were willful, intentional or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years for assisting or advising about the preparation of a false return, statement, or other document under the internal revenue laws.

HOLDING

Taxpayers are not entitled to a refund of the Social Security taxes paid based on

the position that they have waived the right to receive Social Security benefits. Moreover, a taxpayer is not entitled to a charitable contribution deduction based on the purported gift or donation of Social Security taxes or benefits to the government. Claims or deductions based on these positions are frivolous and have no merit.

DRAFTING INFORMATION

This revenue ruling was authored by the Office of Associate Chief Counsel (Procedure and Administration), Administrative Provisions and Judicial Practice Division. For further information regarding this revenue ruling, contact that office at (202) 622-7950 (not a toll-free call).

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions and Other Related Items

Austrian Scholarship MAP Agreement

Announcement 2005–22

Following is a copy of the News Release issued by the Director, International (U.S. Competent Authority) on March 1, 2005 (IR–2005–20).

U.S. and Austria Agree on Tax Treatment of Certain Scholarships

IR–2005–20, March 1, 2005
WASHINGTON — The Competent Authorities of Austria and the United States have reached a mutual agreement on the taxation of certain scholarships under Article 20 (Students and Trainees) and Article

21 (Other Income) of the U.S.-Austria income tax treaty.

The agreement constitutes a Mutual Agreement in accordance with the Income Tax Treaty Between Austria and the United States. The Treaty entered into force on Feb. 1, 1998.

The text of the Agreement is as follows:

COMPETENT AUTHORITY AGREEMENT

The Competent Authorities of Austria and the United States enter into the following agreement (“Agreement”) concerning the interpretation of Articles 20, 21 and 23 of the Convention Between the Republic of Austria and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Income Taxes, signed May 31, 1996. The Agreement is entered into under Article 24 (Mutual Agreement Procedure). For the purposes of this Agreement, “Article” refers to an Article of the Treaty.

It is agreed that the exemption described in Article 20 (Students and Trainees) does not apply to payments for maintenance, education or training received by a student who is, or was immediately before visiting the United States, a resident of Austria, and who is present in the United States for the purpose of full-time education at a recognized education institution, if such scholarship is paid out of U.S. sources, e.g. in the case where the payer of income is a U.S. foundation. Accordingly, such a scholarship payment is taxable according to the domestic tax laws of the United States and Austria.

In any case, pursuant to Article 23 (Non-Discrimination), Austrian students shall not be subjected in the United States to any taxation or any requirement connected therewith, which is other or more burdensome than the taxation and connected requirements to which U.S. nationals in the same circumstances are or may be subjected. This principle would *mutatis mutandis* apply in the reciprocal situation of a U.S. student subject to tax in Austria according to the general rules of Articles 20 and 23.

Furthermore it is understood that a scholarship granted for the purposes of postgraduate research derived by a student, who is present in the other Contracting State only for research purposes, and not for the purposes of full-time education at a recognized educational institution nor for full-time training, is not covered by Article 20 (Students and Trainees). The taxable treatment of such payments would be governed by the rules of Article 21 (Other Income) and thus taxable solely by the State of residence.

Robert H. Green
Director, International (LMSB)
Internal Revenue Service
U.S. Department of the Treasury

Dr. Heinz Jirousek
Deputy Head, International Tax Affairs Division
Federal Ministry of Finance

Date

Date

Part III. Administrative, Procedural, and Miscellaneous

Public Comment Invited on Recommendations for 2005–2006 Guidance Priority List

Notice 2005–25

The Department of Treasury and Internal Revenue Service invite public comment on recommendations for items that should be included on the 2005–2006 Guidance Priority List.

Treasury's Office of Tax Policy and the Service use the Guidance Priority List each year to identify and prioritize the tax issues that should be addressed through regulations, revenue rulings, revenue procedures, notices, and other published administrative guidance. The 2005–2006 Guidance Priority List will establish the guidance that the Treasury Department and the Service intend to issue from July 1, 2005, through June 30, 2006. The Treasury Department and the Service recognize the importance of public input to formulate a Guidance Priority List that focuses resources on guidance items that are most important to taxpayers and tax administration.

As is the case whenever significant legislation is enacted, the Treasury Department and the Service have dedicated substantial resources to published guidance projects necessary to implement the provisions in the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418 ("AJCA"), enacted on October 22, 2004. As a consequence, new guidance projects were added to the Guidance Priority List, as updated on December 21, 2004. The Treasury Department and the Service will continue to evaluate the priority of each guidance project in light of the AJCA and other developments during the 2005–2006 plan year.

In reviewing recommendations and selecting projects for inclusion on the 2005–2006 Guidance Priority List, the Treasury Department and the Service will consider the following:

1. Whether the recommended guidance resolves significant issues relevant to many taxpayers;
2. Whether the recommended guidance promotes sound tax administration;

3. Whether the recommended guidance can be drafted in a manner so that taxpayers can easily understand and apply the guidance;

4. Whether the Service can administer the recommended guidance on a uniform basis; and

5. Whether the recommended guidance reduces controversy and lessens the burden on taxpayers or the Service.

Taxpayers may submit recommendations for guidance at any time during the year. Please submit recommendations by April 30, 2005, for possible inclusion on the original 2005–2006 Guidance Priority List. The Service plans to update the 2005–2006 Guidance Priority List periodically to reflect additional guidance that the Treasury Department and the Service intend to publish during the plan year. The periodic updates allow the Treasury Department and the Service to respond to the need for additional guidance that may arise during the plan year. Recommendations for guidance received after April 30, 2005, will be reviewed for inclusion in the next periodic update.

Taxpayers are not required to submit recommendations for guidance in any particular format. Taxpayers should, however, briefly describe the recommended guidance and explain the need for the guidance. In addition, taxpayers may include an analysis of how the issue should be resolved. It would be helpful if taxpayers suggesting more than one guidance project would prioritize the projects by order of importance. If a large number of projects are being suggested, it would be helpful if the projects were grouped in terms of high, medium or low priority.

Taxpayers should send written comments to:

Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2005–25)
Room 5203
P.O. Box 7604
Ben Franklin Station
Washington, D.C. 20044

or hand deliver comments Monday through Friday between the hours of 8 a.m. and 4 p.m. to:

Courier's Desk
Internal Revenue Service
Attn: CC:PA:LPD:PR
(Notice 2005–25)
1111 Constitution Avenue, N.W.
Washington, D.C. 20224

Alternatively, taxpayers may submit comments electronically via e-mail to the following address: *Notice.Comments@irs.counsel.treas.gov*. Taxpayers should include "Notice 2005–25" in the subject line. All comments will be available for public inspection and copying in their entirety.

For further information regarding this notice, contact Crystal Foster of the Office of Associate Chief Counsel (Procedure and Administration) at (202) 622–7326 (not a toll-free call).

Frivolous Arguments to Avoid When Filing a Return or Claim for Refund

Notice 2005–30

SECTION 1. INTRODUCTION.

As April 15 approaches, taxpayers are reminded to steer clear of abusive tax-avoidance schemes that purportedly allow them to reduce or eliminate taxes. If an idea to save on taxes seems too good to be true, it probably is.

Many abusive tax-avoidance schemes are based on frivolous arguments that the Service and the courts have repeatedly rejected. These schemes are often sold by promoters for a substantial fee, and may be sold over the Internet, through advertisements in newspapers and magazines, at conferences and seminars (including conferences for professional groups such as doctors or dentists), and through recommendations of friends or acquaintances who have learned about these schemes.

Section 2 of this notice sets out some of the most common frivolous arguments used by these abusive tax-avoidance schemes. The Service is committed to identifying taxpayers who attempt to avoid their tax obligations by using schemes based on these and other frivolous arguments. Frivolous returns and other

documents submitted to the Service are processed through its Frivolous Return Program. The Service also reviews other documents that make frivolous arguments to determine whether the individuals who submit these documents have filed required tax returns and paid all taxes due for previous years.

Section 3 of this notice identifies potential civil and criminal penalties. Taxpayers who engage in abusive tax-avoidance schemes will be liable for unpaid taxes and interest. In addition, the Service will impose civil and criminal penalties against taxpayers where appropriate. The Service also will determine appropriate penalties and consider taking other appropriate action against persons who promote these schemes and who prepare frivolous returns based on those schemes.

SECTION 2. COMMON FRIVOLOUS ARGUMENTS.

This section sets out some of the most common frivolous arguments used by taxpayers to avoid or evade tax.

- ***“A taxpayer can avoid tax by filing a return that reports zero income and zero tax liability.”*** All taxpayers who receive more than the statutory minimum amount of gross income, from whatever source derived, must file returns and pay tax. No law, including the Internal Revenue Code, permits a taxpayer who has received wages or other income to file a return with zero income and zero tax liability. If a taxpayer has received income subject to federal tax, a return showing only zeroes for income and tax liability is not a valid return. Further, inclusion of the phrase “nunc pro tunc” or other legal jargon on an income tax return does not serve to validate an otherwise improper return.
- ***“A taxpayer may avoid income tax by referring to a separate ‘straw man’ entity created by the use of the taxpayer’s name in all capital letters in government documents.”*** No authority supports the claim that individuals may avoid their federal income tax obligations based on “straw man” arguments. The use of all uppercase letters when including an individual’s name in government documents has no significance whatsoever.
- ***“Wages are not taxable income, pursuant to section 1001, because taxpayers have basis in their labor equal to the fair market value of the wages they receive; thus, there is no gain to be taxed.”*** All compensation received, no matter what the form of payment, must be included in gross income under section 61. This includes salary or wages paid in cash, as well as the value of property and other economic benefits received from services performed or to be performed in the future. Section 1001 governs gain or loss on the disposition of property, and has no application to compensation for services.
- ***“The 16th Amendment is invalid because it contradicts the original Constitution, was not properly ratified, and lacks an enabling clause.”*** The Sixteenth Amendment to the U.S. Constitution, which authorizes the income tax, was properly ratified by the states and is valid. Further, the argument that the Sixteenth Amendment is invalid due to the lack of an enabling clause is without merit because Congress has the power to lay and collect taxes pursuant to Article 1, Section 8, Clause 18 of the Constitution.
- ***“A taxpayer can make a ‘claim of right’ to exclude the cost of his labor from income.”*** There is no “claim of right” doctrine under any federal law, including the Internal Revenue Code, that permits a taxpayer to deduct or exclude from gross income the value of his labor.
- ***“Only income from a foreign source is taxable under section 861.”*** Sections 861 through 865 do not exclude income from taxable income. In particular, nothing in these sections or the Treasury regulations provides that only income earned from certain foreign sources is subject to U.S. tax.
- ***“I am not a ‘citizen’ or a ‘person’ within the meaning of the Internal Revenue Code.”*** A citizen of any one of the 50 States (e.g., New York, California) of the United States or of the District of Columbia is also a citizen of the United States and is subject to federal tax.
- ***“Residents of States, such as New York or California, are residents of a foreign country and therefore not subject to U.S. income tax.”*** Under its specific conditions and limitations, section 911 permits a taxpayer to elect to exclude income from U.S. taxable income only when the taxpayer earns income abroad and resides outside the geographic boundaries of the United States. For purposes of section 911, States (e.g., New York or California), the District of Columbia, and Commonwealths and Territories of the United States (e.g., Johnston Atoll) are not foreign countries.
- ***“A taxpayer can escape income tax by putting assets in an offshore bank account.”*** A citizen or resident of the United States cannot use an offshore financial arrangement (such as a foreign bank or brokerage account, or a credit card issued by a foreign bank) to avoid his federal tax obligations. Taxpayers are required to disclose foreign financial accounts to the Treasury Department and may face civil and criminal penalties if they fail to do so.
- ***“A taxpayer can eliminate tax by establishing a ‘corporation sole.’”*** A taxpayer cannot avoid income tax by establishing a “corporation sole.” A corporation sole may be used only by a legitimate religious leader for specific, limited purposes relating to the religious leader’s office.
- ***“A taxpayer can place all of his assets in a trust to escape income tax while still retaining control over those assets.”*** A taxpayer who places assets in a trust but retains certain powers or interests over the assets, including the power to control the beneficial enjoyment of the assets, is treated as the owner of the assets for federal tax purposes and is subject to tax on the income from those assets.
- ***“A taxpayer can deduct amounts paid to maintain his household by establishing a home business.”*** Business

expenses, including expenses related to a home-based business, are not deductible unless the expenses relate to a legitimate profit-seeking trade or business. Promoters of home-based business schemes improperly encourage taxpayers to claim household expenses as business expense deductions when the purported home-based business is not a legitimate trade or business.

- **“Nothing in the Internal Revenue Code imposes a requirement to file a return.”** Section 6011 expressly authorizes the Service to require, by Treasury regulation, the filing of tax returns. Section 6012 identifies persons who are required to file income tax returns. Under Treasury regulations, taxpayers who receive more than the statutory minimum amount of gross income must file income tax returns. Taxpayers also are required to pay any tax owed.
- **“Filing a tax return is ‘voluntary.’”** Some people mistake the word “voluntary” for “optional” — but filing a tax return is not optional for those who meet the law’s minimum gross income requirements. The word “voluntary,” as used in IRS publications and elsewhere, refers to the fact that the U.S. tax system is a voluntary *compliance* system. This means only that taxpayers themselves determine the correct amount of tax and complete the appropriate returns, rather than have the government do this for them as is done in some other countries. This system of self-reporting does not make the filing of tax returns or the payment of tax voluntary. For those who do not comply with this system and fail to self-report their tax liability, the tax law authorizes various enforced compliance measures.
- **“Because taxes are voluntary, as an employer, I don’t have to withhold income or employment taxes from my employees.”** Every taxpayer is responsible for completing and filing required returns and paying the correct amount of tax. An employer is required by law to withhold income and employment taxes from salary and wages paid to employees. Employers also must

deposit the amounts withheld with the Service.

- **“A taxpayer can refuse to pay taxes if the taxpayer disagrees with the government’s use of the taxes it collects.”** No law, including the Internal Revenue Code, permits a taxpayer to avoid or evade tax obligations on the grounds that the taxpayer does not agree with the Government’s past or possible future use of the taxes collected.
- **“A taxpayer can escape income taxes or the tax system by submitting a set of documents in lieu of a tax return.”** Taxpayers must file income tax returns using the forms prescribed by the Service. No law, including the Internal Revenue Code, permits taxpayers to submit a document or series of documents to remove themselves from the income tax system.
- **“A taxpayer can avoid tax by filing a return with an attachment that disclaims tax liability.”** A return with an attached disclaimer of tax liability is not a valid tax return under the law.
- **“A taxpayer can avoid tax by filing a return with an altered penalties of perjury statement.”** Alterations to an income tax return or to the penalties of perjury statement may nullify a return.
- **“Certain taxpayers can claim a ‘reparations tax credit’ to right wrongs done in the past.”** No law, including the Internal Revenue Code, permits a “reparations tax credit.”
- **“By purchasing equipment and services for an inflated price, a taxpayer can use the Disabled Access Credit to reduce tax or generate a refund.”** The section 44 Disabled Access Credit, which is limited to expenses for specific medical equipment needed to make a business accessible to disabled individuals, may only be claimed for amounts actually paid by a taxpayer running a legitimate business. Promoters of this scheme improperly offer to sell equipment or services at inflated prices in order to generate a large credit. Taxpayers participating in this scheme, however, ultimately are not

required to pay, and do not pay, the entire price stated in the sales contract.

- **“Under section 3121 taxpayers can deduct the amount of Social Security taxes paid or get a refund of those taxes.”** The Internal Revenue Code imposes Social Security tax on wages as defined in section 3121. Aside from the narrow exception for a religious exemption under section 3127, a taxpayer may not exclude wages from Social Security taxation on the basis that the taxpayer is waiving the right to receive Social Security benefits, and the Code does not authorize a deduction for, or refund of, Social Security taxes paid.
- **“A taxpayer may sell (or purchase) the right to claim a child as a qualifying child for purposes of the EIC.”** A taxpayer may not purchase or sell the right to claim a child as a qualifying child for purposes of the earned income credit (EIC). In order to claim a child as a qualifying child for purposes of the EIC, the child must meet specific relationship, residency and age requirements.

The Service and the courts have repeatedly rejected these arguments and variations on them, and have rejected numerous other tax avoidance schemes and frivolous arguments used by taxpayers to avoid or evade taxes.

SECTION 3. CIVIL AND CRIMINAL PENALTIES.

Civil and criminal penalties may apply to taxpayers who make frivolous arguments. Potentially applicable civil penalties include: (1) the section 6651 additions to tax for failure to file a return, failure to pay the tax owed, and fraudulent failure to file a return; (2) the section 6662 accuracy-related penalty, which is equal to 20 percent of the amount of taxes the taxpayer should have paid; (3) the section 6663 penalty for civil fraud, which is equal to 75 percent of the amount of taxes the taxpayer should have paid; (4) a \$500 penalty under section 6702 for filing a frivolous income tax return; and (5) a penalty of up to \$25,000 under section 6673 if the taxpayer makes frivolous arguments in the United States Tax Court.

Taxpayers who take frivolous positions also may face criminal prosecution for: (1) attempting to evade or defeat tax under section 7201, for which the penalty is a significant fine and imprisonment for up to 5 years; (2) willful failure to file a return under section 7203, for which the penalty is a fine of up to \$25,000 and imprisonment for up to one year; and (3) making false statements on a return, statement, or other document under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years.

Persons, including return preparers, who promote frivolous positions and those who assist taxpayers in claiming tax benefits based on frivolous positions may face penalties and may be enjoined by a court pursuant to sections 7407 and 7408. Potential penalties include: (1) a \$250 penalty under section 6694 for each return or claim for refund prepared by an income tax return preparer who knew or should have known that the taxpayer's position was frivolous (or \$1,000 for each return or claim for refund if the return preparer's actions were willful, intentional or reckless); (2) a penalty under section 6700 for promoting abusive tax shelters; (3) a \$1,000 penalty under section 6701 for aiding and abetting the understatement of tax; and (4) criminal prosecution under section 7206, for which the penalty is a significant fine and imprisonment for up to 3 years for assisting or advising about the preparation of a false return, statement or other document under the internal revenue laws.

SECTION 4. EFFECT ON OTHER DOCUMENTS.

Notice 2004-22 is modified and superseded.

SECTION 5. ADDITIONAL INFORMATION.

Other information about frivolous tax positions is available on the Service website at www.irs.gov.

The principal author of this notice is the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact that office at (202) 622-7800 (not a toll-free call).

State and Local General Sales Tax Deduction

Notice 2005-31

This notice provides guidance to taxpayers regarding the election to deduct state and local general sales taxes in lieu of state and local income taxes under § 164(b)(5) of the Internal Revenue Code for taxpayers who elect to itemize deductions under § 63(e). Section 164(b)(5) was added by § 501 of the American Jobs Creation Act of 2004, Pub. L. No. 108-357, and applies for taxable years beginning after December 31, 2003, and before January 1, 2006.

BACKGROUND

Section 164(a)(3) provides, in part, that taxpayers may deduct state and local income taxes in the taxable year the taxes are paid or incurred. Under § 164(b)(5), taxpayers may elect to deduct state and local general sales taxes in lieu of state and local income taxes.

A general sales tax is a tax imposed at one rate with respect to the retail sale of a broad range of classes of items. Section 164(b)(5)(B). In determining whether the tax is imposed on a broad range of classes of items, the fact that sales taxes do not apply to some or all food, clothing, medical supplies, and motor vehicles is disregarded. Section 164(b)(5)(C)(i). In determining whether the tax is imposed at one rate, the fact that the tax rate that applies to food, clothing, medical supplies, or motor vehicles is lower than the general tax rate is disregarded. Section 164(b)(5)(C)(ii).

In general, sales taxes that are imposed at a rate other than the general rate of tax are not deductible. However, sales taxes imposed on (1) food, clothing, medical supplies, or motor vehicles at a rate lower than the general rate of tax may be deducted, and (2) motor vehicles at a rate in excess of the general sales tax rate may be deducted only at the general sales tax rate. Section 164(b)(5)(D) and (F).

If the amount of a sales tax is separately stated and paid by the consumer (other than in connection with a trade or business), the amount of the tax is treated as a tax imposed on and paid by the consumer rather than the seller. Therefore, the consumer may deduct sales taxes that are im-

posed on the seller if the tax is separately stated (as on a contract or receipt) and paid by the consumer. Section 164(b)(5)(G).

A compensating use tax is treated as a sales tax if the tax (1) is imposed on the use, storage, or consumption of an item, and (2) is complementary to a general sales tax that would be deductible with respect to similar items. Section 164(b)(5)(E).

Taxpayers who elect to deduct state and local sales taxes may deduct either actual sales taxes paid or incurred, as evidenced by appropriate records, or an amount determined under tables provided by the Service. For 2004, tables are provided in Publication 600, *Optional State Sales Tax Tables*. A taxpayer who elects to use the optional sales tax tables may deduct (1) the amount determined under the tables, as provided in the instructions, plus (2) the actual amount of state and local general sales taxes paid on motor vehicles, boats, and certain other specified items. Section 164(b)(5)(H).

APPLICATION

Manner of making election to deduct sales taxes

Taxpayers elect to deduct state and local general sales taxes in lieu of state and local income taxes on Form 1040, Schedule A, in accordance with the instructions. A taxpayer may elect to deduct state and local general sales taxes in one taxable year and state and local income taxes in another taxable year. The election for a taxable year for which the period of limitation for filing a claim for refund or credit under § 6511 has not expired may be revoked by filing an amended return for that taxable year.

Definition of motor vehicle

For purposes of deducting state and local general sales taxes, a "motor vehicle" includes an automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van, or truck (any of which may be either purchased or leased). For these items, if sales taxes are imposed at rates that exceed the general sales tax rate, sales tax may be deducted only at the general sales tax rate.

Determination of amount of sales taxes paid by using the optional sales tax tables

The optional sales tax tables provide an amount of sales taxes paid based on a taxpayer's state of residence, total available income, and number of exemptions.

The state of residence is the state where the taxpayer physically resides. A taxpayer who lives in different states during the taxable year who elects to use the optional sales tax tables must multiply the amount determined under the tables for each state of residence by a fraction, the numerator of which is the number of days physically resident in the state and the denominator of which is the number of days in the year.

Example. Taxpayer S lives in State A from January 1 through August 31, 2004 (244 days), and in State B from September 1 through December 31, 2004 (122 days). The amount of S's deduction for state and local sales taxes determined under the optional sales tax tables would be \$500 if S had lived in State A for the entire year and \$400 if S had lived in State B for the entire year. S's deduction for state and local sales taxes is \$466 calculated as follows:

State A:	$\$500 \times 244/366 = \333
State B:	$\$400 \times 122/366 = \underline{\$133}$
Total	\$466

Total available income is adjusted gross income (AGI) plus amounts not reflected in AGI that increase spendable income, such as worker's compensation, public assistance payments, military compensation earned in a combat zone, tax-exempt interest, the refundable portion of refundable tax credits, and the nontaxable part of social security, veterans' or railroad retirement benefits and of IRA, pension or annuity distributions.

The number of exemptions is the number included on the taxpayer's tax return. See special rule, below, for taxpayers filing a joint return and living in different states.

Deductions for local general sales taxes under the optional sales tax tables

For 2004, the amounts provided in the optional sales tax tables do not include amounts paid for local general sales taxes. For 2004, taxpayers may add amounts paid for local general sales taxes to the amount determined under the tables. For 2004, the amount of local general sales taxes paid

may be determined by multiplying the taxpayer's state table amount by the ratio of the local sales tax rate to the state sales tax rate.

Example. State A imposes a 5.0% general sales tax in 2004. City B in State A imposes an additional 1.0% general sales tax in 2004. Taxpayer C lives in City B. Taxpayer C's deduction for state sales taxes determined under the optional sales tax tables is \$1,000. To calculate the additional amount for the City B local sales tax, divide 1.0 (the local City B tax rate) by 5.0 (the State A tax rate). The result is 0.2. Multiply Taxpayer C's deduction for state sales taxes determined under the optional sales tax tables by 0.2. The additional City B local sales tax is \$200. Taxpayer C's deductible State A and local sales tax is \$1,000 + \$200, or \$1,200 (before adding the tax on any specified items).

For 2005, it is expected that the optional sales tax tables will include local sales taxes if local sales taxes are imposed at a uniform rate throughout the state. It is also expected that for 2005, taxpayers will be allowed to determine the deduction for local sales taxes in the manner discussed above if local sales taxes not included in the optional sales tax tables are imposed on the same items taxed by the state. In states where state sales taxes and local sales taxes are not imposed on the same items, instructions accompanying the optional sales tax tables for 2005 may provide specific information for determining the amount of local sales taxes from the optional sales tax tables. If none of the preceding options is available to a taxpayer for 2005, the taxpayer may deduct only actual local sales taxes paid or incurred, as evidenced by appropriate records.

Specified items on which sales taxes may be deducted by taxpayers using the optional sales tax tables

In addition to the amount determined under the optional sales tax tables and amounts added for local general sales taxes, taxpayers may deduct allowable actual state and local general sales taxes paid on the purchase of the following items: motor vehicles (including automobiles, motorcycles, motor homes, recreational vehicles, sport utility vehicles, off-road vehicles, vans, and trucks), boats, aircraft, homes (including mobile and prefabricated homes), and materials to build a home.

Use of the optional sales tax tables by taxpayers filing a joint tax return and living in different states

Taxpayers who file a joint return, live in different states, and use the optional sales tax tables must calculate the amount of the deduction for state and local sales taxes by applying their separate incomes to the table for each state of residence, taking into account the exemptions for dependents who resided with each taxpayer, and adding the total. Either spouse (but not both) may take into account dependents who did not reside with either taxpayer.

Deduction of state and local sales taxes by taxpayers filing tax returns as married filing separately

A married taxpayer filing a separate tax return who elects to deduct state and local sales taxes must use the optional sales tax tables if the taxpayer's spouse elects to deduct sales taxes and uses the optional sales tax tables.

In using the optional sales tax tables, a married taxpayer filing a separate return must apply the taxpayer's separate income and the number of exemptions included on the taxpayer's return.

Example. Taxpayers W and H are married, have three children, and file their tax returns as married filing separately. W's total available income is \$40,000, and W includes exemptions for herself and one child on her tax return. H's total available income is \$60,000, and H includes exemptions for himself and two children on his tax return. W determines the amount of her deduction for state and local sales taxes under the optional sales tax tables based on \$40,000 income and two exemptions. Thus, H must determine the amount of his deduction for state and local sales taxes under the optional sales tax tables based on \$60,000 income and three exemptions.

DRAFTING INFORMATION

The principal author of this notice is David M. Christensen of the Office of the Associate Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Christensen at (202) 622-7900 (not a toll-free call).

Rev. Proc. 2005-19

SECTION 1. PURPOSE

To minimize disputes regarding the determination of whether a truck body satisfies the weight-based exclusion provided in § 4051(a)(2) of the Internal Revenue Code, the Service, as a matter of administrative convenience, has established certain body type classification safe harbors.

SECTION 2. BACKGROUND

.01 *In General.* Section 4051(a)(1) imposes a tax on the first retail sale of certain enumerated articles including automobile truck chassis and bodies and truck trailer and semitrailer chassis and bodies. Section 4051(a)(2) provides an exclusion from the tax imposed by § 4051(a)(1) for truck chassis and bodies suitable for use with a vehicle that has a gross vehicle weight (GVW) of 33,000 pounds or less. Similarly, § 4051(a)(3) provides an exclusion for truck trailer and semitrailer chassis and bodies suitable for use with a trailer or semitrailer that has a GVW of 26,000 pounds or less.

Section 145.4051-1(a)(4) of the Temporary Excise Tax Regulations Under the Highway Revenue Act of 1982 (Pub. L. 97-424) provides the following rules for determining whether automobile truck chassis and bodies are suitable for use with a vehicle which has a gross vehicle weight of 33,000 pounds or less and whether truck trailer or semitrailer chassis and bodies are suitable for use with a trailer or semitrailer which has a gross vehicle weight of 26,000 pounds or less. The term “suitable for use” is defined as practical and commercial fitness for such use. In addition, a chassis or body possesses practical fitness for use with a vehicle if it performs its intended function up to a generally acceptable standard of efficiency with the vehicle, and a chassis or body possesses commercial fitness for use with

a vehicle if it is generally available for use with the vehicle at a price that is reasonably competitive with other articles that may be used for the same purpose. Thus, a truck chassis which is suitable for use with a vehicle having a gross vehicle weight of 33,000 pounds or less, is not subject to the tax imposed by § 4051(a)(1) regardless of the body actually mounted thereon. If an exempt body is mounted on a taxable chassis (or a taxable body is mounted on an exempt chassis) and the resulting vehicle is a highway vehicle as defined in § 48.4061(a)-1 of the Manufacturers and Retailers Excise Tax Regulations, the taxable chassis or body, as the case may be, nevertheless remains subject to such tax.

Under § 145.4051-1(e)(3)(ii), a seller of a completed chassis, body, or vehicle must establish a weight rating for each article sold. Since the weight rating of the chassis and the GVW of a completed vehicle would normally be the same, a truck chassis seller is aided in establishing a weight rating for a chassis by the guidelines set forth in § 145.4051-1(e)(3)(v). Section 145.4051-1(e)(3)(v) generally defines GVW as the maximum total weight of a loaded vehicle.

.02 *Reason for Revenue Procedure.* Section 145.4051-1(e)(3)(v) simplifies sellers’ determinations of whether chassis meet the “suitable for use” standard for a weight-based exclusion. However, since there are no federal excise tax guidelines to establish a weight rating for a truck body, and because many truck bodies are specialized in nature, sellers do not routinely ascribe GVW ratings to the bodies they sell. In some cases, sellers do not know the GVW of the vehicle on which the body (or similar bodies sold by others) will be mounted. Thus, it may be difficult for a seller of a truck body to determine whether the body meets the “suitable for use” standard for a weight-based exclusion.

SECTION 3. APPLICATION

.01 *Classifications of Truck Body Types.* The Service will not challenge a seller’s determination that any of the following

classifications of truck body types meet the “suitable for use” standard and sales thereof are excluded from the retail excise tax by virtue of § 4051(a)(2):

(1) Platform truck bodies 21 feet or less in length;

(2) Dry freight and refrigerated truck van bodies 24 feet or less in length;

(3) Dump truck bodies with load capacities of 8 cubic yards or less; or

(4) Refuse packer truck bodies with load capacities of 20 cubic yards or less.

.02 *Bodies Not Within a Classification.* The Service has established the classifications set forth in section 3.01 after a review of manufacturers’ and retailers’ data for certain truck body types. A body type described above that does not fall within the classification parameters of its body type (for example, a platform truck body longer than 21 feet), or a body type not described above, may nevertheless still satisfy the “suitable for use” standard if the seller can establish that, pursuant to § 145.4051-1(a)(4), the truck body has practical and commercial fitness for use with a vehicle having a GVW of 33,000 pounds or less.

SECTION 4. EFFECTIVE DATE

This revenue procedure is effective for sales on or after April 4, 2005. In the case of sales before April 4, 2005, the Service will not challenge sellers who take positions consistent with this revenue procedure with respect to sales of truck bodies described in section 3.01.

DRAFTING INFORMATION

The principal author of this revenue procedure is Theodore N. Margopulos of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this revenue procedure, contact Barbara Franklin at (202) 622-3130 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Sickness or Accident Disability Payments

REG-160315-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations that provide guidance regarding the treatment of payments made on account of sickness or accident disability under a workers' compensation law for purposes of the Federal Insurance Contributions Act (FICA).

DATES: Written and electronic comments must be received by June 9, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-160315-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-160315-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayer may submit comments electronically, via the IRS Internet site at www.irs.gov/regs or via Federal Rulemaking Portal at www.regulations.gov (IRS and REG-160315-03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Ford of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-6040; concerning submissions of comments, the hearing and/or to be placed on the building access list to attend the hearing, LaNita Van Dyke (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to 26 CFR part 31 under section 3121 of the Internal Revenue Code (the Code.) Section 3121(a)(2)(A) of the Code excepts from "wages" for FICA tax purposes payments to an employee or any of his dependents on account of sickness or accident disability only if the payments are received under a "workmen's compensation law", hereinafter referred to as a workers' compensation law. The amendment to the regulations provides that for purposes of section 3121(a)(2)(A) a workers' compensation law includes a statute in the nature of a workers' compensation act.

Explanation of Provisions

Current Law

Section 3121(a) defines wages for FICA purposes as all remuneration for employment unless specifically excepted. Section 3121(a)(2)(A) excepts from wages the amount of any payment (including any amount paid by an employer for insurance or annuities, or into a fund, to provide for any such payment) made to or on behalf of, an employee or any of his dependents under a plan or system established by an employer which makes provision for his employees generally (or for his employees generally and their dependents) or for a class or classes of his employees (or for a class or classes of his employees and their dependents), on account of sickness or accident disability, but only if the employee receives the payments under a workers' compensation law. Section 3121(a)(4) provides that wages does not include any payment on account of sickness or accident disability made by an employer to or on behalf of an employee after the expiration of 6 calendar months following the last calendar month in which the employee worked for the employer. Thus, unless made under a workers' compensation law, payments received on account of

sickness or accident disability are wages subject to FICA during the first 6 months the employee is out of work.

Prior to its amendment by section 3(b)(1) of Public Law 97-123, (95 Stat. 1659, 1982-6 I.R.B. 7) (the 1981 Act), section 3121(a)(2)(B), the predecessor to section 3121(a)(2)(A), excluded from wages any payments made under a plan or system established by an employer on account of sickness or accident disability. There was no requirement that payments be made under a workers' compensation law. Thus, the 1981 Act narrowed the sick pay exclusion by limiting the exclusion from FICA to payments made under a workers' compensation law. Section 3(e) of the 1981 Act did not amend the Code, but specifies for purposes of section 3121(a) of the Code that a payment under a workers' compensation law does not include a payment made pursuant to a State temporary disability insurance law.

On July 6, 1982, the IRS issued Temporary regulations (T.D. 7823, 1982-2 C.B. 223 [47 FR 29225] July 6, 1982). Section 32.1(a)(1) of the Temporary Employment Tax Regulations follows the amendments made by the 1981 Act providing that payments on account of sickness or accident disability are excluded from wages for FICA purposes only if paid under a workers' compensation law. Section 32.1(a)(1). Further, Section 32.1(c) provides that a payment under a workers' compensation law does not include a payment made pursuant to a State temporary disability insurance law. Thus, such payments are wages for FICA purposes. The temporary regulations do not address the FICA tax treatment of payments made under a statute in the nature of a workers' compensation act.¹

For income tax purposes, section 104(a)(1) provides that gross income does not include amounts received under workers' compensation acts as compensation for personal injuries or sickness. Section 1.104-1(b) of the Income Tax Regulations states that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workers'

¹ To provide guidance relating to changes made by the Act, the IRS published Revenue Procedure 82-20, 1982-1 C.B. 466, which provided in Q&A 1 that payments under a statute in the nature of a workers' compensation act were excluded from FICA. Rev. Proc. 82-20 was obsolete by Revenue Procedure 95-43, 1995-2 C.B. 412, which provides that the temporary regulations generally restate the guidance in Q&A-1 through Q&A-9 of Rev. Proc. 82-20.

compensation act or under a statute in the nature of a workers' compensation act that provides compensation to the employee for personal injury or sickness incurred in the course of employment.

The IRS takes the position that gross income for income tax purposes is a separate concept from wages for purposes of FICA. Furthermore, exclusions from wages for FICA purposes are to be construed narrowly. Thus, amounts that are excluded from gross income, in the absence of a specific statutory or regulatory exclusion from wages, constitute wages for FICA.

Pursuant to the income tax regulations, payments made under a statute in the nature of a workers' compensation act are excluded from gross income under section 104. However, there is no regulation at present addressing whether such payments are excluded from wages for FICA purposes.

Through 1989, the IRS issued several private letter rulings concluding that payments made under a statute in the nature of a workers' compensation act were excluded from gross income and exempt from FICA. In 1990, based on the Service's position that the exclusion from gross income did not necessarily result in an exclusion from wages, and the absence of a regulation on point, the IRS reversed its ruling position with respect to FICA, holding that payments made under a statute in the nature of a workers' compensation act are included in wages, until the employee has been absent from work in excess of six months; once the employee has been absent from work for more than six months, the payments are excluded from FICA by section 3121(a)(4).

Questions have arisen concerning the FICA tax treatment of payments made under a statute in the nature of a workers' compensation act to employees of states and local governments who are not eligible to receive payments under a workers' compensation law. Accordingly, the IRS and Treasury are seeking to provide rules to clarify the treatment of such payments during the first six months the employee is out of work.

Under the proposed regulations, payments made under a statute in the nature of a workers' compensation act will be treated as having been made under a workers' compensation law and, therefore, will be excluded from wages for FICA pur-

poses. Thus, the regulations adopt the same position that was published in Rev. Proc. 82-20, the most contemporaneous guidance to the legislation that created the current statutory scheme. The proposed regulations thus align the interpretation of what constitutes payments received under a workers' compensation law for purposes of section 3121(a)(2)(A) with the interpretation of amounts received under a workers' compensation law for purposes of section 104(a)(1).

These proposed regulations are intended to address only the treatment of payments under a statute in the nature of a workers' compensation act for FICA purposes. The existing temporary regulations under section 31.1 which address the FICA treatment of payments under a workers' compensation law also provide guidance to third parties making payments on account of sickness or accident disability. Treasury and the IRS are not proposing any changes to the regulations with respect to the FICA treatment of third-party sick pay. To the extent it is necessary to modify the temporary regulations to harmonize them with these proposed regulations, the third-party sick pay provisions will be preserved. To the extent necessary, future guidance will also address the treatment of payments on account of sickness or accident disability for Federal Unemployment Tax Act and Railroad Retirement Tax Act purposes.

Proposed Effective Date

It is proposed that these regulations apply to payments made on or after the date the proposed regulation is published as Final in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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. In addition, because no collection of information is imposed on small entities, the provisions of the Regulatory Flexibility Act (5 U.S.C. chapter 6) do not apply, and, therefore, a Regulatory Flexibility Analysis is not required. Pursuant to

section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on the impact on small business.

Comments and Requests for Public Hearing

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

Drafting Information

The principal author of these regulations is David Ford of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt/Government Entities). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

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

Paragraph 1. The authority section for part 31 continues to read, in part, as follows:

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

Par. 2. Section 31.3121(a)(2)-1 is amended by:

1. Revising the section heading.
2. Removing paragraph (a)(1).
3. Redesignating paragraphs (a)(2) through (a)(4) as (a)(1) through (a)(3), respectively.
4. Revising paragraph (a)(1).

5. Redesignating paragraph (d) as paragraph (f).

6. Adding paragraphs (d) and (e).

The revisions and additions are as follows:

§31.3121(a)(2)–1 Payments on account of sickness or accident disability, medical or hospitalization expenses, or death.

(a) * * *

(1) Sickness or accident disability of an employee or any of his dependents, only if payment is received under a workers' compensation law;

(2) Medical or hospitalization expenses in connection with sickness or accident disability of an employee or any of his dependents, or

(3) Death of an employee or any of his dependents.

* * * * *

(d) *Workers' compensation law.* (1) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law includes a payment made pursuant to a statute in the nature of a workers' compensation act.

(2) For purposes of paragraph (a)(1) of this section, a payment made under a workers' compensation law does not include a payment made pursuant to a State temporary disability insurance law.

(3) If an employee receives a payment on account of sickness or accident disability that is not made under a workers' compensation law or a statute in the nature of a workers' compensation act, the payment is not excluded from wages as defined by section 3121(a)(2)(A) even if the payment must be repaid if the employee receives a workers' compensation award or an award under a statute in the nature of a workers' compensation act with respect to the same period of absence from work.

(4) If an employee receives a payment on account of non-occupational injury sickness or accident disability such payment is not excluded from wages, as defined by section 3121(a)(2)(A).

(e) *Examples.* The following examples illustrate the principles of paragraph (d) of this section:

Example 1. A local government employee is injured while performing work-related activities. The employee is not covered by the State workers' compensation law, but is covered by a local government ordinance that requires the local government to pay the employee's full salary when the employee is out

of work as a result of an injury incurred while performing services for the local government. The ordinance does not limit or otherwise affect the local government's liability to the employee for the work-related injury. The local ordinance is not a workers' compensation law, but it is in the nature of a workers' compensation act. Therefore, the salary the employee receives while out of work as a result of the work-related injury is excluded from wages under section 3121(a)(2)(A).

Example 2. The facts are the same as in *Example 1* except that the local ordinance requires the employer to continue to pay the employee's full salary while the employee is unable to work due to an injury whether or not the injury is work-related. Thus, the local ordinance does not limit benefits to instances of work-related disability. A benefit paid under an ordinance that does not limit benefits to instances of work-related injuries is not a statute in the nature of a workers' compensation act. Therefore, the salary the injured employee receives from the employer while out of work is wages subject to FICA even though the employee's injury is work-related.

Example 3. The facts are the same as in *Example 1* except that the local ordinance includes a rebuttable presumption that certain injuries, including any heart attack incurred by a firefighter or other law enforcement personnel is work-related. The presumption in the ordinance does not eliminate the requirement that the injury be work-related in order to entitle the injured worker to full salary.

Therefore, the ordinance is a statute in the nature of a workers' compensation act, and the salary the injured employee receives pursuant to the ordinance is excluded from wages under section 3121(a)(2)(A).

* * * * *

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

(Filed by the Office of the Federal Register on March 10, 2005, 8:45 a.m., and published in the issue of the Federal Register for March 11, 2005, 70 F.R. 12164)

Notice of Proposed Rulemaking

Transactions Involving the Transfer of No Net Value

REG-163314-03

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations providing guidance regarding corporate formations, reorganizations, and liquidations of insolvent corpo-

rations. These regulations provide rules requiring the exchange (or, in the case of section 332, a distribution) of net value for the nonrecognition rules of subchapter C to apply to the transaction. The regulations also provide guidance on determining when and to what extent creditors of a corporation will be treated as proprietors of the corporation in determining whether continuity of interest is preserved in a potential reorganization. Finally, the regulations provide guidance on whether a distribution in cancellation or redemption of less than all of the shares one corporation owns in another corporation satisfies the requirements of section 332. The proposed regulations affect corporations and their shareholders.

DATES: Written and electronic comments and requests for a public hearing must be received by June 8, 2005.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-163314-03), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. to 4 p.m. to CC:PA:LPD:PR (REG-163314-03), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC or sent electronically, via the IRS internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS and REG-163314-03).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations on the reorganization provisions and regarding issues raised by the proposed regulations with respect to provisions other than those related to corporate liquidations and subchapter K, Jean Brenner, (202) 622-7790; concerning the proposed regulations on corporate liquidations, Sean McKeever, (202) 622-7750; concerning the application of the principles of the proposed regulations to transfers of property to partnerships under subchapter K, Jeanne Sullivan or Michael Goldman, (202) 622-3070; concerning submissions of comments and/or requests for a public hearing, Treena Garrett, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

General Background

The IRS and the Treasury Department believe that there is a need to provide a comprehensive set of rules addressing the application of the nonrecognition rules of subchapter C of the Internal Revenue Code (Code) to transactions involving insolvent corporations and to other transactions that raise similar issues. The proposed regulations provide three sets of rules, the principal one of which is that the nonrecognition rules of subchapter C do not apply unless there is an exchange (or, in the case of section 332, a distribution) of net value (the “net value requirement”). The proposed regulations also provide guidance on the circumstances in which (and the extent to which) creditors of a corporation will be treated as proprietors of the corporation in determining whether continuity of interest is preserved in a potential reorganization. The proposed regulations further provide guidance on whether a distribution in cancellation or redemption of less than all of the shares one corporation owns in another corporation satisfies the requirements of section 332. Each of these rules is discussed separately in this preamble.

Explanation of Provisions

Exchange of Net Value Requirement

Background

In subchapter C, each of the rules described below that provides for the general nonrecognition of gain or loss refers to a distribution in cancellation or redemption of stock or an exchange for stock. Section 332 provides, in part, that “[n]o gain or loss shall be recognized on the receipt by a corporation of property distributed in complete liquidation of another corporation . . . only if . . . the distribution is by such other corporation *in complete cancellation or redemption of all its stock.*” Section 351 provides, in part, that “[n]o gain or loss shall be recognized if property is transferred to a corporation by one or more persons *solely in exchange for stock* in such corporation.” Section 354 provides, in part, that “[n]o gain or loss shall be recognized if stock or securities in a corporation a party to a reorganization are . . . *exchanged solely for stock or se-*

curities . . . in another corporation a party to the reorganization.” Finally, section 361 provides that “[n]o gain or loss shall be recognized to a corporation if such corporation is a party to a reorganization and *exchanges property . . . solely for stock or securities* in another corporation a party to the reorganization.”

The authorities interpreting section 332 have consistently concluded that the language of the statute referring to a distribution in complete cancellation or redemption of stock requires a distribution of net value. Section 1.332-2(b) provides that section 332 applies only if a parent receives at least partial payment for the stock that it owns in the liquidating corporation. Such payment could not occur unless there were a distribution of net value. The courts have focused in numerous cases on the effect of liabilities on the distribution requirement of section 332. In *H. G. Hill Stores, Inc. v. Commissioner*, 44 B.T.A. 1182 (1941), a subsidiary liquidated and distributed its assets and liabilities to its parent in cancellation of its indebtedness to its parent. The court interpreted the phrase “in complete cancellation or redemption of all its stock” as requiring that a distribution be made to the parent in its capacity as a stockholder in order for section 112(b)(6) (the predecessor of section 332) to apply and, thus, held that section 112(b)(6) did not apply because the parent corporation received payment in its capacity as a creditor and not in its capacity as a stockholder. See also Rev. Ruls. 2003-125, 2003-2 C.B. 1243, 70-489, 1970-2 C.B. 53, and 59-296, 1959-2 C.B. 87.

Rev. Rul. 59-296 holds that the principles relevant to liquidations under section 332 also apply to reorganizations under section 368. However, other authorities are not consistent with the approach of Rev. Rul. 59-296. Most notably, in *Norman Scott, Inc. v. Commissioner*, 48 T.C. 598 (1967), the Tax Court held that a transaction involving an insolvent target corporation qualified as a reorganization under section 368(a)(1)(A).

The IRS and the Treasury Department have decided to resolve the uncertainties by generally adopting a net value requirement for each of the described nonrecognition rules in subchapter C. The net value requirement generally requires that there be an exchange of property for stock, or in the case of section 332, a distribution

of property in cancellation or redemption of stock. The IRS and the Treasury Department believe that the net value requirement is the appropriate unifying standard because it is more consistent with the statutory framework of subchapter C, case law, and published guidance than any other approach considered. In addition, the IRS and the Treasury Department believe that the net value requirement is the appropriate standard because transactions that fail the requirement, that is, transfers of property in exchange for the assumption of liabilities or in satisfaction of liabilities, resemble sales and should not receive nonrecognition treatment.

The IRS and the Treasury Department considered several other approaches to unify and rationalize the nonrecognition rules of subchapter C as they applied to transactions involving insolvent corporations. The IRS and the Treasury Department considered whether there should be special rules for potential nonrecognition transactions between members of a consolidated group. Such rules might disregard the various exchange requirements in the statute because of the single entity principles generally applicable to corporations joining in the filing of a consolidated return. This approach was rejected because there is no consolidated return policy that compels a different set of rules for potential nonrecognition transactions between members of a consolidated group. Cf. §1.1502-35T(f)(1); Notice 94-49, 1994-1 C.B. 358. The current intercompany transaction rules (in particular those regarding successors in §1.1502-13(j)) could be modified to extend deferral of gain and loss to additional situations as long as the assets remained in the consolidated group pending later acceleration events that befall the assets or successor entities. However, no such rules are being proposed because the case for treating the transferor and transferee members as a single entity seems weakest when the group’s equity investment in the transferor has been eliminated.

The IRS and the Treasury Department also considered whether satisfying the words of the relevant statutory provisions that describe the relationship of the parties to a transaction should be sufficient for applying the nonrecognition rules to a transaction between the parties. This approach would essentially take the position

that the words of distribution or exchange in the statute do not state a separate requirement but merely describe the most common form of the transaction to which the provision is intended to apply. For example, under this approach, it would be sufficient for a transaction to qualify as a distribution in complete liquidation under section 332 if the corporation to which assets are transferred owned stock meeting the requirements of section 1504(a)(2) at the time of the transfer. Also, under this approach, it would be sufficient for a transaction to qualify as a transfer under section 351 if a transferor of assets were in control (as defined in section 368(c)) of the corporation to which assets are transferred immediately after the transaction. However, this approach would require distinguishing, when the structure of the statute does not, between parts of a statute that impose requirements and other parts that do not.

Explanation of rules

Net Value Requirement

For potential liquidations under section 332, the net value requirement is effected by the partial payment rule in §1.332-2(b) of the current regulations. The proposed regulations make no modifications to this rule, except, as discussed below, for transactions in which the recipient corporation owns shares of multiple classes of stock in the dissolving corporation. The proposed regulations also make minor changes to other sections of the regulations under section 332 to conform those regulations to changes in the statute.

For potential transactions under section 351, the proposed regulations add §1.351-1(a)(1)(iii)(A), which requires a surrender of net value and, in paragraph (a)(1)(iii)(B), a receipt of net value. This rule is similar to that for potential asset reorganizations, discussed below. The proposed regulations make minor changes to other sections of the regulations under section 351 to conform those regulations to changes in the statute.

For potential reorganizations under section 368, the proposed regulations modify §1.368-1(b)(1) to add the requirement that there be an exchange of net value. Section 1.368-1(f) of the proposed regulations sets forth the rules for determin-

ing whether there is an exchange of net value. These rules require, in paragraph (f)(2)(i) for potential asset reorganizations and paragraph (f)(3)(i) for potential stock reorganizations, a surrender of net value and, in paragraph (f)(2)(ii) for potential asset reorganizations and paragraph (f)(3)(ii) for potential stock reorganizations, a receipt of net value. In a potential asset reorganization (one in which the target corporation would not recognize gain or loss under section 361), the target corporation surrenders net value if the fair market value of the property transferred by it to the acquiring corporation exceeds the sum of the amount of liabilities of the target corporation that are assumed by the acquiring corporation and the amount of any money and the fair market value of any property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by the target corporation. This rule ensures that a target corporation transfers property in exchange for stock. The IRS and the Treasury Department believe that the proposed rule better identifies whether a target corporation transfers property in exchange for stock than a rule that looks to the issuance or failure to issue stock because, when the parties are related, the issuance or failure to issue stock might be meaningless.

In a potential stock reorganization (one which would be described in section 368(a)(1)(B) or section 368(a)(1)(A) by reason of section 368(a)(2)(E)), the rules are modified to reflect the fact that the target corporation remains in existence. A potential reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(E) must satisfy the asset reorganization test for the merger of the controlled corporation into the target corporation (for which test the controlled corporation is treated as the target corporation) and the stock reorganization test for the acquisition of the target corporation.

In a potential asset reorganization, the target corporation receives net value if the fair market value of the assets of the issuing corporation exceeds the amount of its liabilities immediately after the exchange. This rule ensures that the target corporation receives stock (or is deemed to receive stock under the “meaningless gesture” doctrine) having value. This rule is necessary because the IRS and the Treasury Department believe that the receipt of

worthless stock in exchange for assets cannot be part of an exchange for stock.

Scope of Net Value Requirement

The proposed regulations provide in §1.368-1(b)(1) that the net value requirement does not apply to reorganizations under section 368(a)(1)(E) and 368(a)(1)(F). The IRS and the Treasury Department recently issued final regulations (T.D. 9182, 2005-11 I.R.B. 713 [70 FR 9219] (Feb. 25, 2005)) stating that a continuity of business enterprise and a continuity of interest are not required for a transaction to qualify as a reorganization under section 368(a)(1)(E) or (F) because applying the requirements in those contexts is not necessary to protect the policies underlying the reorganization provisions. Because the purpose underlying the net value requirement is the same as that underlying the continuity of interest requirement, the IRS and the Treasury Department have similarly concluded that applying the net value requirement to transactions under section 368(a)(1)(E) or (F) is not necessary to protect the policies underlying the reorganization provisions.

The proposed regulations also provide in §1.368-1(b)(1) and §1.368-1(f)(4) that the net value requirement does not apply to a limited class of transactions that qualify as reorganizations under section 368(a)(1)(D). That class of transactions are the transactions exemplified by *James Armour, Inc. v. Commissioner*, 43 T.C. 295 (1964), and Rev. Rul. 70-240, 1970-1 C.B. 81. The IRS and the Treasury Department acknowledge that the conclusions of the described authorities are inconsistent with the principles of the net value requirement. Nevertheless, the IRS and the Treasury Department currently desire to preserve the conclusions of these authorities while they more broadly study issues relating to acquisitive reorganizations under section 368(a)(1)(D), including the continuing vitality of various liquidation-reincorporation authorities after the enactment of the Tax Reform Act of 1986, Public Law 99-514 (100 Stat. 2085 (1986)). Consistent with the described authorities, the exception is limited to acquisitive reorganizations of solvent target corporations. The proposed regulations provide no specific guidance (other than in an example incorporating the facts of

Rev. Rul. 70-240, 1970-1 C.B. 81), other than with regard to the application of the net value requirement, on when a transaction will qualify as a reorganization under section 368(a)(1)(D). In this regard, compare *Armour with Warsaw Photographic Associates, Inc. v. Commissioner*, 84 T.C. 21 (1985).

Definition of Liabilities

In applying the proposed regulations, taxpayers must determine the amount of liabilities of the target corporation that are assumed by the acquiring corporation. Although the proposed regulations do not define the term liability, the IRS and the Treasury Department intend that the term be interpreted broadly. Thus, for purposes of the proposed regulations, a liability should include any obligation of a taxpayer, whether the obligation is debt for federal income tax purposes or whether the obligation is taken into account for the purpose of any other Code section. Generally, an obligation is something that reduces the net worth of the obligor. The IRS and the Treasury Department have proposed adopting a similar definition of liability for purposes of implementing section 358(h) in subchapter K. See Prop. Reg. §1.752-1(a)(1)(ii) and Prop. Reg. §1.752-7(b)(2)(ii) (REG-106736-00, 2003-2 C.B. 60 [68 FR 37434]) (June 24, 2003).

Amount of Liabilities

The proposed regulations provide no specific guidance on determining the amount of a liability. The IRS and the Treasury Department are currently considering various approaches to determining the amount of a liability. One approach would be to treat the amount of a liability represented by a debt instrument as its adjusted issue price determined under sections 1271 through 1275 of the Code (the OID rules) (perhaps with exceptions for certain contingent payment debt instruments) while treating the amount of other liabilities as the value of such liabilities. Another approach would be to treat the amount of all liabilities as the value of such liabilities. Other approaches could borrow in whole or in part from other authorities such as those relevant to the determination of insolvency under

section 108(d)(3). One method for valuing liabilities is to determine the amount of cash that a willing assignor would pay to a willing assignee to assume the liability in an arm's-length transaction. Cf. Prop. Reg. §1.752-7(b)(2)(ii).

In the course of developing these regulations, the IRS and the Treasury Department considered special issues related to the assumption of nonrecourse liabilities in the context of a transaction to which section 332, 351, or 368 might apply. The IRS and the Treasury Department are considering a rule similar to the one in Rev. Rul. 92-53, 1992-2 C.B. 48, that would disregard the amount by which a nonrecourse liability exceeds the fair market value of the property securing the liability when determining the amount of liabilities that are assumed. For example, under such a rule, if an individual transfers an apartment building with a fair market value of \$175x subject to a nonrecourse obligation of \$190x and an adjacent lot of land with a fair market value of \$10x to a corporation, the transferor will have surrendered net value because the fair market value of the assets transferred (\$175x + \$10x) exceeds the amount of the liabilities assumed (\$190x - \$15x, the amount of the excess nonrecourse indebtedness). Any rule disregarding excess nonrecourse indebtedness would be limited to the application of the net value requirement and would have no relevance for other federal income tax purposes, such as the determination of the amount realized under section 1001. Comments are requested regarding the treatment of nonrecourse indebtedness and the effect of such treatment when both property subject to the nonrecourse indebtedness and other property are transferred.

Assumption of Liabilities

In general, the IRS and the Treasury Department believe that the principles of section 357(d) should be applied to determine whether a liability is assumed when more than one person might bear responsibility for the liability. Comments are requested regarding whether and to what extent the principles of section 357(d) should be incorporated into the regulations.

The IRS and the Treasury Department believe that transfers of assets in satisfaction of liabilities should be treated the

same as transfers of assets in exchange for the assumption of liabilities. Accordingly, in determining whether there is a surrender of net value, the proposed regulations treat any obligation of the target corporation for which the acquiring corporation is the obligee as a liability assumed by the acquiring corporation.

In Connection With

The proposed regulations take into account not only liabilities assumed in the exchange, but also liabilities assumed "in connection with" the exchange. The proposed regulations include this rule so that the timing of an acquiring corporation's assumption of a target corporation's liability (or a creditor's discharge of a target corporation's indebtedness), whether before an exchange, in the exchange, or after the exchange, will have the same effect in determining whether there is a surrender of net value in the exchange. The proposed regulations also take into account, in determining whether there is a surrender of net value, money and other nonstock consideration received by the target corporation in connection with the exchange.

The IRS and the Treasury Department intend that the substance-over-form doctrine and other nonstatutory doctrines be used in addition to the "in connection with" rule in determining whether the purposes and requirements of the net value requirement are satisfied. Cf. Rev. Rul. 68-602, 1968-2 C.B. 135 (holding that a parent corporation's cancellation of a wholly-owned subsidiary's indebtedness to it that is an integral part of a liquidation is transitory and, therefore, disregarded).

Section 368(a)(1)(C)

The proposed regulations remove the statement in §1.368-2(d)(1) that the assumption of liabilities may so alter the character of a transaction as to place the transaction outside the purposes and assumptions of the reorganization provisions. Because the proposed regulations provide more specific guidance regarding when the assumption of liabilities will prevent a transaction from qualifying as a reorganization under section 368(a)(1)(C), the IRS and the Treasury Department believe the statement is unnecessary.

Section 721

The IRS and the Treasury Department recognize that the principles in the proposed rules under section 351 may be applied by analogy to other Code sections that are somewhat parallel in scope and effect, such as section 721, dealing with the contribution of property to a partnership in exchange for a partnership interest. The IRS and the Treasury Department request comments on whether rules similar to the rules of the proposed regulations should be proposed in the context of subchapter K and the considerations that might justify distinguishing the relevant provisions in subchapter K from those provisions that are the subject of these proposed regulations.

Continuity of Interest

Background

The Code provides general nonrecognition treatment for reorganizations described in section 368. A transaction must comply with both the statutory requirements of the reorganization provisions and various nonstatutory requirements, including the continuity of interest requirement, to qualify as a reorganization. See §1.368-1(b). The purpose of the continuity of interest requirement is to ensure that reorganizations are limited to readjustments of continuing interests in property under modified corporate form and to prevent transactions that resemble sales from qualifying for nonrecognition of gain or loss available to corporate reorganizations. See §§1.368-1(b), 1.368-1(e)(1). Continuity of interest requires that a substantial part of the value of the proprietary interests in the target corporation be preserved in the reorganization. See §1.368-1(e)(1); see also *LeTulle v. Scofield*, 308 U.S. 415 (1940); *Helvering v. Minnesota Tea Co.*, 296 U.S. 378 (1935); *Pinellas Ice & Cold Storage Co. v. Commissioner*, 287 U.S. 462 (1933); *Cortland Specialty Co. v. Commissioner*, 60 F.2d 937 (2d Cir. 1932), cert. denied, 288 U.S. 599 (1933).

Generally, it is the shareholders who hold the proprietary interests in a corporation. However, when a corporation is in bankruptcy, the corporation's stock may be worthless and eliminated in the restructuring. In this case, when the corporation engages in a potential reorganization,

its creditors may receive acquiring corporation stock in exchange for their claims and its shareholders may receive nothing. Thus, without special rules, most potential reorganizations of corporations in bankruptcy would fail the continuity of interest requirement. The Supreme Court addressed this problem in *Helvering v. Alabama Asphaltic Limestone Co.*, 315 U.S. 179 (1942), in which it held that, for practical purposes, the old continuity of interest in the shareholders shifted to the creditors not later than the time "when the creditors took steps to enforce their demands against the insolvent debtor. In this case, that was the date of the institution of bankruptcy proceedings. From that time on, they had effective command over the property." See also *Palm Springs Holding Corp. v. Commissioner*, 315 U.S. 185 (1942) (holding that the legal procedure employed by the creditors to obtain effective command over a corporation's property was not material when the corporation was insolvent). Notwithstanding *Palm Springs*, it is not clear when creditors of an insolvent corporation not in a title 11 or similar case may be considered proprietors for purposes of satisfying the continuity of interest requirement.

In *Atlas Oil & Refining Corp. v. Commissioner*, 36 T.C. 675 (1961), the court held that only creditors who in fact receive stock in the acquiring corporation, by relation back, can be deemed to have been equity owners at the time of the transfer. The court stated that the fact that a more senior class of creditors may have had "effective command" over the assets in the case will not make them proprietors if they do not in fact exercise their right to receive stock in the acquiring corporation.

In the Bankruptcy Tax Act of 1980, Public Law 96-589 (94 Stat. 3389 (1980)), Congress added section 368(a)(1)(G), providing for a new type of reorganization applicable to corporations in title 11 or similar cases. In the legislative history to that statute, Congress stated its expectation that the courts and the Treasury Department would determine whether the continuity of interest requirement is satisfied in a potential reorganization under section 368(a)(1)(G) by treating as proprietors the most senior class of creditors who received stock, together with all interests equal and junior to them, including shareholders. See S. Rep. No. 1035, 96th Cong., 2d Sess. 36-37 (1980). This for-

mulation is similar to the relation back analysis that the Tax Court used in *Atlas Oil*.

Explanation of provisions

The proposed regulations add new §1.368-1(e)(6), which describes the circumstances in which creditors of a corporation generally, and which creditors in particular, will be treated as holding a proprietary interest in a target corporation immediately before a potential reorganization. In general, the proposed rules adopt the standard for reorganizations under section 368(a)(1)(G) recommended in the Senate Finance Committee Report to the Bankruptcy Tax Act of 1980. The proposed regulations also provide that creditors of an insolvent target corporation not in a title 11 or similar case may be treated as holding a proprietary interest in the corporation even though they take no steps to obtain effective command over the corporation's property, other than their agreement to receive stock in the potential reorganization. The proposed regulations, at §1.368-1(e)(6)(ii), provide specific guidance on how to quantify the proprietary interest of the target corporation so that taxpayers may determine whether a substantial part of the value of the proprietary interests in the target corporation is preserved in the potential reorganization. Because a creditor of a corporation may hold claims in more than one class, the proposed regulations generally refer to claims of a particular class of creditors rather than to creditors in a particular class.

The proposed regulations treat claims of the most senior class of creditors to receive a proprietary interest in the issuing corporation and claims of all equal classes of creditors (together, the senior claims) differently from the claims of classes of creditors junior to the senior claims (the junior claims). The proposed regulations treat senior claims as representing, in part, a creditor claim against the corporation, and, in part, a proprietary interest in the corporation. This rule mitigates the adverse effect on continuity of interest of senior creditors seeking payment primarily in nonstock consideration while still taking some payment in shares of stock of the acquiring corporation. The determination of what part of a senior claim is a proprietary interest in the target corporation is

made by calculating the average treatment for all senior claims. Thus, the proposed regulations, at §1.368-1(e)(2)(ii)(B), provide that the value of a proprietary interest in the target corporation represented by a senior claim is determined by multiplying the fair market value of the creditor's claim by a fraction, the numerator of which is the fair market value of the proprietary interests in the issuing corporation that are received in the aggregate in exchange for the senior claims, and the denominator of which is the sum of the amount of money and the fair market value of all other consideration (including the proprietary interests in the issuing corporation) received in the aggregate in exchange for such claims. The effect of this rule is that there is 100 percent continuity of interest if each senior claim is satisfied with the same ratio of stock to nonstock consideration and no junior claim is satisfied with nonstock consideration.

The proposed regulations, at §1.368-1(e)(6)(ii)(A), provide that the entire amount of a junior claim represents a proprietary interest in the target corporation immediately before the potential reorganization. Thus, the value of the proprietary interest represented by that claim is the fair market value of the claim (which value is generally determined by reference to the amount of money and the fair market value of the consideration received in exchange therefor).

The rules in the proposed regulations are intended to work in conjunction with the current continuity of interest rules. Accordingly, the proposed regulations modify §1.368-1(e)(1)(ii), relating to the effect on continuity of interest of distributions or redemptions before a potential reorganization, and §1.368-1(e)(2), relating to the effect on continuity of interest of acquisitions of proprietary interests by persons related to the issuing corporation, to ensure that the purpose of these rules is effected when creditors' claims represent the proprietary interests in the target corporation.

Section 332

Background

Section 332 requires that a subsidiary's liquidating distribution to its parent corporation be in complete cancellation or re-

demption of all its stock. In *Spaulding Bakeries, Inc. v. Commissioner*, 252 F.2d 693 (2d Cir. 1958), aff'g 27 T.C. 684 (1957), the Second Circuit concluded that for a distribution to be made in cancellation or redemption of "all the stock," payment must be made on each class of stock. See also *H. K. Porter Co. v. Commissioner*, 87 T.C. 689 (1986).

Explanation of provisions

The current regulations provide that section 332 applies only to those cases in which the recipient corporation receives at least partial payment for the stock that it owns in the liquidating corporation. The proposed regulations clarify that section 332 applies only to those cases in which the recipient corporation receives at least partial payment for each class of stock that it owns in the liquidating corporation, an interpretation consistent with the Second Circuit's holding in *Spaulding Bakeries* and the Tax Court's holding in *H. K. Porter*. The IRS and the Treasury Department have adopted this approach because they believe that it is appropriate for a taxpayer to recognize loss when it fails to receive a distribution on a class of stock in liquidation of its subsidiary. The recipient corporation would recognize such a loss if the distribution qualified as a reorganization.

The proposed regulations also confirm that when the liquidation fails to qualify under section 332 because the recipient corporation did not receive at least partial payment for each class of stock but did receive at least partial payment for at least one class of stock, the transaction may qualify as a corporate reorganization under section 368.

Proposed Effective Date

These proposed regulations will apply to transactions that occur after the date they are published as final regulations in the **Federal Register**.

Special Analyses

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

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

Comments and Requests for Public Hearing

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

Drafting Information

The principal authors of these proposed regulations are Jean Brenner and Sean McKeever of the Office of Associate Chief Counsel (Corporate). However, other personnel from the IRS and the Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 is amended by revising the entry for "Section 1.351-1" to read, in part, as follows:

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

Section 1.351-1 also issued under 26 U.S.C. 351. * * *

Par. 2. Section 1.332-2 is amended by:

1. Revising the first sentence of paragraph (a).
2. Revising paragraph (b).
3. Revising the heading of the Example in paragraph (e).
4. Adding *Example 2* to paragraph (e).

The revisions and addition read as follows:

§1.332-2 Requirements for nonrecognition of gain or loss.

(a) The nonrecognition of gain or loss is limited to the receipt of property by a corporation that is the actual owner of stock (in the liquidating corporation) meeting the requirements of section 1504(a)(2). * * *

(b) Section 332 applies only when the recipient corporation receives at least partial payment for each class of stock that it owns in the liquidating corporation. If section 332 does not apply, see section 165(g) regarding the allowance of losses for worthless securities for a class of stock for which no payment is received. Further, if section 332 does not apply and the recipient corporation receives partial payment for at least one class of stock that it owns in the liquidating corporation, see section 368(a)(1) regarding potential qualification of the distribution as a reorganization. If section 332 does not apply and the distribution does not qualify as a reorganization, see section 331 for those classes of stock for which partial payment is received.

* * * * *

(e) * * *

Example 1. * * *

Example 2. P Corporation owns all of the outstanding preferred and common stock of Q Corporation. The preferred stock is not stock described in section 1504(a)(4). The fair market value of Q Corporation's assets exceeds the amount of its liabilities but does not exceed the liquidation preference on the Q Corporation's preferred stock. Q Corporation liquidates and distributes all of its assets to P Corporation. P Corporation receives partial payment for its Q Corporation preferred stock but receives nothing for its Q Corporation common stock. The receipt by P Corporation of the properties of Q Corporation is not a distribution received by P Corporation in complete liquidation of Q Corporation within the meaning of section 332. Thus, under section 165(g), P Corporation is entitled to a worthless security deduction for its Q Corporation common stock. The transaction may qualify as a reorganization under section 368(a)(1)(C). If the transaction does not qualify as a

reorganization, P Corporation will recognize gain or loss on its Q Corporation preferred stock under section 331.

Par. 3. Section 1.351-1 is amended by:

1. Revising the first sentence of paragraph (a)(1) introductory text.
2. Adding a sentence after the last sentence in paragraph (a)(1) introductory text and revising the phrase "For purposes of this section" at the end of paragraph (a)(1) introductory text to read "In addition, for purposes of this section".
3. Revising paragraphs (a)(1)(i) and (a)(1)(ii).
4. Removing the concluding text immediately following paragraph (a)(1)(ii).
5. Adding paragraphs (a)(1)(iii) and (a)(1)(iv).
6. Adding *Example 4* at the end of paragraph (a)(2).
7. Revising paragraph (b)(1).

The revisions, removal, and additions read as follows:

§1.351-1 Transfer to corporation controlled by transferor.

(a)(1) Section 351(a) provides, in general, for the nonrecognition of gain or loss upon the transfer by one or more persons of property to a corporation solely in exchange for stock of such corporation if, immediately after the exchange, such person or persons are in control of the corporation to which the property was transferred. * * * For purposes of this section, stock rights and stock warrants are not included in the term *stock*. In addition, for purposes of this section —

(i) Stock will not be treated as issued for property if it is issued for services rendered or to be rendered to or for the benefit of the issuing corporation;

(ii) Stock will not be treated as issued for property if it is issued for property which is of relatively small value in comparison to the value of the stock already owned (or to be received for services) by the person who transferred such property and the primary purpose of the transfer is to qualify under this section the exchanges of property by other persons transferring property; and

(iii) Stock will not be treated as issued for property if either —

(A) The fair market value of the transferred property does not exceed the sum of the amount of liabilities of the transferor

that are assumed by the transferee in connection with the transfer and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 351(a) without the recognition of gain) received by the transferor in connection with the transfer. For this purpose, any obligation of the transferor for which the transferee is the obligee that is extinguished for federal income tax purposes in connection with the transfer is treated as a liability assumed by the transferee; or

(B) The fair market value of the assets of the transferee does not exceed the amount of its liabilities immediately after the transfer;

(iv) Paragraph (a)(1)(iii) of this section applies to transfers occurring after the date these proposed regulations are published as final regulations in the **Federal Register**.

(2) * * *

* * * * *

Example 4. A, an individual, transfers an apartment building with a fair market value of \$175x to Corporation X. The building is subject to a nonrecourse obligation of \$190x and no other asset is subject to that liability. A receives 10 shares of Corporation X stock in the exchange. Immediately after the exchange, Corporation X is solvent and A owns 100% of its outstanding stock. Under paragraph (a)(1)(iii) of this section, the 10 shares of Corporation X stock received by A will not be treated as issued for property because the fair market value of the apartment building does not exceed the amount of A's liabilities assumed by Corporation X. Therefore, section 351 does not apply to the exchange.

* * * * *

(b)(1) When property is transferred to a corporation by two or more persons in exchange for stock, as described in paragraph (a) of this section, and the stock received is received in disproportion to the transferor's prior interest in such property, the entire transaction will be given tax effect in accordance with its true nature, and the transaction may be treated as if the stock had first been received in proportion and then some of such stock had been used to make gifts (section 2501 *et seq.*), to pay compensation (sections 61(a)(1) and 83(a)), or to satisfy obligations of the transferor of any kind.

* * * * *

Par. 4. Section 1.368-1 is amended by:

1. Removing the last sentence of paragraph (a).

2. Redesignating paragraph (b) as paragraph (b)(1).

3. Removing the third sentence of paragraph (b)(1) and adding two sentences in its place.

4. Removing the seventh sentence of paragraph (b)(1).

5. Adding paragraph (b)(2).

6. Adding a sentence after the fifth sentence of paragraph (e)(1)(i).

7. Adding a sentence at the end of paragraph (e)(1)(ii).

8. Revising the text of paragraph (e)(2).

9. Redesignating paragraphs (e)(6) and (e)(7) as paragraphs (e)(7) and (e)(8), respectively, and adding a new paragraph (e)(6).

10. Adding *Example 10* to the end of paragraph (e)(7).

11. Adding a sentence at the end of paragraph (e)(8).

12. Adding paragraph (f).

The additions and revisions read as follows:

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

(b)(1) *** Requisite to a reorganization under the Internal Revenue Code are a continuity of business enterprise through the issuing corporation under the modified corporate form as described in paragraph (d) of this section, a continuity of interest as described in paragraph (e) of this section (except as provided in section 368(a)(1)(D)), and an exchange of net value as described in paragraph (f) of this section. Notwithstanding the requirements of this paragraph (b)(1), an exchange of net value is not required for a transaction to qualify as a reorganization under section 368(a)(1)(E) or (F) and, to the extent provided in paragraph (f)(4), for a transaction to qualify as a reorganization under section 368(a)(1)(D). ***

(2) *Effective dates.* The third and fourth sentences of paragraph (b)(1) of this section apply to transactions occurring after the date these proposed regulations are published as final regulations in the **Federal Register**. The fifth and sixth sentences apply to transactions occurring after January 28, 1998, except that they do not apply to any transaction occurring pursuant to a written agreement which is

binding on January 28, 1998, and at all times thereafter.

(e) ***

(1) ***

(i) *** See paragraph (e)(6) of this section for rules related to when a creditor's claim against a target corporation is a proprietary interest in the corporation. ***

(ii) *** A proprietary interest in the target corporation is not preserved to the extent that creditors (or former creditors) of the target corporation that own a proprietary interest in the corporation under paragraph (e)(6) of this section (or would be so treated if they had received the consideration in the potential reorganization) receive payment for the claim prior to the potential reorganization.

(2) *** A proprietary interest in the target corporation is not preserved if, in connection with a potential reorganization, a person related (as defined in paragraph (e)(3) of this section) to the issuing corporation acquires either a proprietary interest in the target corporation or stock of the issuing corporation that was furnished in exchange for a proprietary interest in the target corporation for consideration other than stock of the issuing corporation. The preceding sentence does not apply to the extent those persons who were the direct or indirect owners of the target corporation prior to the potential reorganization maintain a direct or indirect proprietary interest in the issuing corporation.

(6) *Creditors' claims as proprietary interests*—(i) *In general.* A creditor's claim against a target corporation may be a proprietary interest in the target corporation if the target corporation is in a title 11 or similar case (as defined in section 368(a)(3)) or the amount of the target corporation's liabilities exceeds the fair market value of its assets immediately prior to the potential reorganization. In such cases, if any creditor receives a proprietary interest in the issuing corporation in exchange for its claim, every claim of that class of creditors and every claim of all equal and junior classes of creditors (in addition to the claims of shareholders) is a proprietary interest in the target corporation immediately prior to the potential reorganization.

(ii) *Value of proprietary interest*—(A) *In general.* Generally, if a creditor's claim

is a proprietary interest in the target corporation, the value of the proprietary interest is the fair market value of the creditor's claim.

(B) *Claims of creditors of most senior classes.* For a claim of the most senior class of creditors receiving a proprietary interest in the issuing corporation and a claim of any equal class of creditors, the value of the proprietary interest in the target corporation represented by the claim is determined by multiplying the fair market value of the claim by a fraction, the numerator of which is the fair market value of the proprietary interests in the issuing corporation that are received in the aggregate in exchange for the claims of those classes of creditors, and the denominator of which is the sum of the amount of money and the fair market value of all other consideration (including the proprietary interests in the issuing corporation) received in the aggregate in exchange for such claims.

(iii) *Bifurcated claims.* If a creditor's claim is bifurcated into a secured claim and an unsecured claim pursuant to an order in a title 11 or similar case (as defined in section 368(a)(3)) or pursuant to an agreement between the creditor and the debtor, the bifurcation of the claim and the allocation of consideration to each of the resulting claims will be respected in applying the rules of this paragraph (e)(6).

(iv) *Effect of treating creditors as proprietors.* The treatment of a creditor's claim as a proprietary interest in the target corporation shall not preclude treating shares of the target corporation as proprietary interests in the target corporation.

(7) ***

Example 10. Creditors treated as owning a proprietary interest. T has assets with a fair market value of \$150x and liabilities of \$200x. T has two classes of creditors, the senior creditors with claims of \$50x, and the junior creditors with claims of \$150x. T transfers all of its assets to P in exchange for \$95x and shares of P stock with a fair market value of \$55x. The T senior creditors receive in the aggregate \$40x and P stock with a fair market value of \$10x in exchange for their claims. Each T senior creditor receives stock and nonstock consideration in the same proportion. The T junior creditors receive \$55x and P stock with a fair market value of \$45x in exchange for their claims. The T shareholders receive no consideration in exchange for their T stock. Under paragraph (e)(6) of this section, because the amount of T's liabilities exceeds the fair market value of its assets immediately prior to the potential reorganization, the claims of the creditors of T may be proprietary interests in T. Because the senior creditors receive propri-

etary interests in P in the transaction in exchange for their claims, their claims and the claims of the junior creditors and the T shareholders are treated as proprietary interests in T immediately prior to the transaction. Under paragraph (e)(6)(ii) of this section, the value of the senior creditors' proprietary interests in T is \$10x, the value of the proprietary interests in P that they received in exchange for their claims. In addition, the value of the junior creditors' proprietary interests in T immediately prior to the transaction is \$100x, the value of their claims. Because P is treated as acquiring 50 percent of the value of the proprietary interests in T in exchange for P stock (\$55x/\$110x), a substantial part of the value of the proprietary interests in T is preserved. Therefore, the continuity of interest requirement is satisfied.

(8) * * * The sixth sentence of paragraph (e)(1)(i) of this section, the last sentence of paragraph (e)(1)(ii) of this section, paragraph (e)(2) of this section, paragraph (e)(6) of this section, and *Example 10* of paragraph (e)(7) of this section apply to transactions occurring after the date these proposed regulations are published as final regulations in the **Federal Register**.

(f) *Exchanges of net value*—(1) *General rule*. An exchange of net value requires that there be both a surrender of net value and a receipt of net value. Whether there is a surrender of net value is determined by reference to the assets and liabilities of the target corporation. Whether there is a receipt of net value is determined by reference to the assets and liabilities of the issuing corporation (as defined in paragraph (b) of this section). The purpose of the exchange of net value requirement is to prevent transactions that resemble sales (including transfers of assets in satisfaction of liabilities) from qualifying for non-recognition of gain or loss available to corporate reorganizations.

(2) *Asset transactions*. There is an exchange of net value in a potential reorganization to which section 361 would apply only if —

(i) *Surrender of net value*. The fair market value of the property transferred by the target corporation to the acquiring corporation exceeds the sum of the amount of liabilities of the target corporation that are assumed by the acquiring corporation in connection with the exchange and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by the target corporation in connection with the exchange. For this purpose, any obligation of the target cor-

poration for which the acquiring corporation is the obligee that is extinguished for federal income tax purposes in connection with the exchange is treated as a liability assumed by the acquiring corporation; and

(ii) *Receipt of net value*. The fair market value of the assets of the issuing corporation exceeds the amount of its liabilities immediately after the exchange.

(3) *Stock transactions*. There is an exchange of net value in a potential reorganization under section 368(a)(1)(B) or section 368(a)(1)(A) by reason of section 368(a)(2)(E) only if —

(i) *Surrender of net value*. The fair market value of the assets of the target corporation exceeds the sum of the amount of the liabilities of the target corporation immediately prior to the exchange and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 354 without the recognition of gain and nonqualified preferred stock within the meaning of section 351(g)) received by the shareholders of the target corporation in connection with the exchange. For this purpose, assets of the target corporation that are not held immediately after the exchange and liabilities of the target corporation that are extinguished for federal income tax purposes in the exchange other than ones, if any, to the corporation into which the target corporation merges in the case of a potential reorganization under section 368(a)(1)(A) by reason of section 368(a)(2)(E) are disregarded; and

(ii) *Receipt of net value*. The fair market value of the assets of the issuing corporation exceeds the amount of its liabilities immediately after the exchange.

(4) *Exception*. The requirement that there be an exchange of net value does not apply to a transaction that would otherwise qualify as a reorganization under section 368(a)(1)(D) by reason of section 354 or so much of section 356 as relates to section 354, provided that the fair market value of the property transferred to the acquiring corporation by the target corporation exceeds the amount of liabilities of the target corporation immediately before the exchange (including any liabilities cancelled, extinguished, or assumed in connection with the exchange), and the fair market value of the assets of the acquiring corporation equals or exceeds the amount

of its liabilities immediately after the exchange.

(5) *Examples*. For purposes of the examples in this paragraph (f)(5), each of P, S, and T is a corporation; all corporations have only one class of stock outstanding; A, B, C, and D are individuals; and the transaction is not otherwise subject to recharacterization. Except as otherwise provided, no person is related to any other person and the fair market value of the assets of each corporation exceeds the amount of its liabilities immediately prior to the transaction described in the example. The following examples illustrate the application of this paragraph (f).

Example 1. T has assets with a fair market value of \$50x and liabilities of \$75x, all of which are owed to A. T transfers all of its assets to S in exchange for S stock with a fair market value of \$50x. T distributes the S stock to A in exchange for the T debt owed to A. T dissolves. T's shareholders receive nothing in exchange for their T stock. Under paragraph (f)(2)(i) of this section, T surrenders net value because the fair market value of the property transferred by T (\$50x) exceeds the sum of the amount of liabilities that are assumed by S in connection with the exchange (\$0x) and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by T in connection with the exchange (\$0x). In addition, under paragraph (f)(2)(ii) of this section, T receives net value because the fair market value of the assets of S exceeds the amount of its liabilities immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value.

Example 2. P owns all of the stock of both S and T. T has assets with a fair market value of \$100x and liabilities of \$160x, all of which are owed to P. T transfers all of its assets to S in exchange for S stock with a fair market value of \$100x. T distributes the S stock to P in exchange for the T debt owed to P. T dissolves. P receives nothing in exchange for its T stock. Under paragraph (f)(2)(i) of this section, T surrenders net value because the fair market value of the property transferred by T (\$100x) exceeds the sum of the amount of liabilities of T assumed by S in connection with the exchange (\$0x) and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by T in connection with the exchange (\$0x). In addition, under paragraph (f)(2)(ii) of this section, T receives net value because the fair market value of the assets of S exceeds the amount of its liabilities immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value. The result would be the same if no S stock were issued.

Example 3. The facts are the same as in *Example 2*, except that T's debt is owed to B. T transfers all of its assets to S in exchange for the assumption of T's liabilities. T dissolves. The obligation to B is outstanding immediately after the transfer. P receives nothing in exchange for its T stock. Under paragraph

(f)(2)(i) of this section, T does not surrender net value because the fair market value of the property transferred by T (\$100x) does not exceed the sum of the amount of liabilities of T assumed by S in connection with the exchange (\$160x). Therefore, under paragraph (f) of this section, there is no exchange of net value. The result would be the same if S stock were issued.

Example 4. The facts are the same as in *Example 3*, except that S first assumes the T debt owed to B and subsequently T transfers all of its assets to S in exchange for S stock with a fair market value of \$100x. If S's assumption of the T debt is made in connection with the subsequent transfer of T assets to S, under paragraph (f)(2)(i) of this section, T does not surrender net value because the fair market value of the property transferred by T (\$100x) does not exceed the sum of the amount of liabilities of T assumed by S in connection with the exchange (\$160x). Therefore, under paragraph (f) of this section, there is no exchange of net value.

Example 5. P owns 70% of the stock of T. A owns the remaining 30% of the stock of T. T has assets with a fair market value of \$100x and liabilities of \$160x, all of which are owed to P. T merges into P. A receives nothing in exchange for its T stock. Under (f)(2)(i) of this section, even though T's obligation to P is extinguished in the transaction, it is treated as a liability assumed by P. Thus, under paragraph (f)(2)(i) of this section, T does not surrender net value because the fair market value of the property transferred by T (\$100x) does not exceed the sum of the amount of liabilities of T assumed by P in connection with the exchange (\$160x). Therefore, under paragraph (f) of this section, there is no exchange of net value.

Example 6. A owns all of the stock of S. S has assets with a fair market value of \$200x and liabilities of \$500x, all of which are owed to T. The S debt has a fair market value of \$200x. In addition to the S debt, T has other assets that have a fair market value of \$700x. T has no liabilities. T transfers all of its assets to S in exchange for S stock with a fair market value of \$900x. T distributes the S stock to its shareholders in exchange for their T stock. T dissolves. S cancels all of its stock held by its shareholders immediately prior to the exchange. Under paragraph (f)(2)(i) of this section, T surrenders net value because the fair market value of the property transferred by T (\$900x) exceeds the sum of the amount of liabilities of T assumed by S in connection with the exchange (\$0x) and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by T in connection with the exchange (\$0x). In addition, under paragraph (f)(2)(ii) of this section, T receives net value because the fair market value of the assets of S (\$900x) exceeds the amount of the liabilities of S (\$0x) immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value.

Example 7. P owns all of the stock of S. T has assets with a fair market value of \$300x and liabilities of \$650x, \$500x of which are owed to P and \$150x of which are owed to A. T merges into S. In the merger, P stock is issued to A in satisfaction of the debt owed to A by T. Also in the merger, P contributes to the capital of T the debt P is owed. Assume the merger would qualify as a reorganization under sec-

tion 368(a)(1)(A) by reason of section 368(a)(2)(D) if the exchange of net value requirement in paragraph (f)(1) of this section did not apply. Whether there is a surrender of net value is determined by reference to the actual merger of T into S. Thus, T surrenders net value because the fair market value of the property transferred by T (\$300x) exceeds the sum of the amount of liabilities of T assumed by S in connection with the exchange (\$0x) and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 361(a) without the recognition of gain) received by T in connection with the exchange (\$0x). Whether there is a receipt of net value is determined by reference to the issuing corporation, in this case, P. T receives net value because the fair market value of the assets of P exceeds the amount of the liabilities of P immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value.

Example 8. P owns all of the stock of both S and T. T transfers all of its assets to S in exchange for \$34x, the assets' fair market value. Following this transfer, T pays its debts of \$2x and dissolves, distributing the remaining \$32x to P. Assume the transaction would qualify as a reorganization under section 368(a)(1)(D) by reason of section 354 or so much of section 356 as relates to section 354 if the net value requirement in paragraph (f)(1) of this section did not apply. Under paragraph (f)(2) of this section, there is no exchange of net value because the fair market value of the property transferred by T (\$34x) does not exceed the amount of money received by T in connection with the exchange (\$34x). However, under paragraph (f)(4) of this section, because the transaction would otherwise qualify as a reorganization under section 368(a)(1)(D) and the other requirements of paragraph (f)(4) of this section are satisfied, the exchange of net value requirement does not apply. Accordingly, the transaction qualifies as a reorganization under section 368(a)(1)(D).

Example 9. A and B own all of the stock of T. T has assets with a fair market value of \$500x and liabilities of \$900x, all of which are owed to C and D, security holders of T. P acquires all of the stock and securities of T in exchange for P voting stock. In the transaction, A and B receive nothing in exchange for their stock of T. C and D exchange all of their securities of T for stock of P. Under paragraph (f)(3)(i) of this section, there is a surrender of net value because the fair market value of the assets of T held immediately prior to the exchange that are held immediately after the exchange (\$500x) exceeds the sum of the amount of liabilities of T immediately prior to the exchange (\$0x, disregarding the liabilities of \$900x extinguished in the exchange) and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 354 without the recognition of gain and non-qualified preferred stock within the meaning of section 351(g)) received by the shareholders of T (\$0x). In addition, under paragraph (f)(3)(ii) of this section, there is a receipt of net value because the fair market value of the assets of P exceeds the amount of the liabilities of P immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value.

Example 10. A and B own all of the stock of P, and C and D own all of the stock of T. P has assets with

a fair market value of \$400x and liabilities of \$500x, and T has assets with a fair market value of \$1000x and liabilities of \$600x. P acquires all of the stock of T. C and D exchange all of their T stock, with a fair market value of \$400x, for P stock with a fair market value of \$300x immediately after the transaction. P cancels all of the stock held by A and B immediately prior to the exchange. Under paragraph (f)(3)(i) of this section, there is a surrender of net value because the fair market value of the assets of T held immediately prior to the exchange that are held immediately after the exchange (\$1000x) exceeds the amount of liabilities of T (\$600x) immediately prior to the exchange and the amount of any money and the fair market value of any other property (other than stock permitted to be received under section 354 without the recognition of gain and nonqualified preferred stock within the meaning of section 351(g)) received by the shareholders of T (\$0x). In addition, under paragraph (f)(3)(ii) of this section, there is a receipt of net value because the fair market value of the assets of P (\$800x), which includes the fair market value of the stock of T, exceeds the amount of its liabilities (\$500x) immediately after the exchange. Therefore, under paragraph (f) of this section, there is an exchange of net value. To the extent that C and D surrender T stock with a value in excess of the value of the P stock they receive, the tax consequences of the surrender of the additional stock are determined based on the facts and circumstances.

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

Par. 5. Section 1.368-2 is amended by revising paragraph (d)(1) to read as follows:

§1.368-2 Definition of terms.

* * * * *

(d) * * *

(1)(i) One corporation must acquire substantially all the properties of another corporation solely in exchange for all or part of its own voting stock, or solely in exchange for all or a part of the voting stock of a corporation which is in control of the acquiring corporation. For example, Corporation P owns all the stock of Corporation A. All the properties of Corporation W are transferred to Corporation A either solely in exchange for voting stock of Corporation P or solely in exchange for less than 80 percent of the voting stock of Corporation A. Either of such transactions constitutes a reorganization under section 368(a)(1)(C). However, if the properties of Corporation W are acquired in exchange for voting stock of both Corporation P and Corporation A, the transaction will not constitute a reorganization under sec-

tion 368(a)(1)(C). In determining whether the exchange meets the requirement of “solely for voting stock,” the assumption by the acquiring corporation of liabilities of the transferor corporation, or the fact that property acquired from the transferor corporation is subject to a liability, shall be disregarded. Section 368(a)(1)(C) does not prevent consideration of the effect of an assumption of liabilities on the general character of the transaction but merely provides that the requirement that the exchange be solely for voting stock is satisfied if the only additional consideration is an assumption of liabilities.

(ii) Paragraph (d)(1)(i) of this section applies to transactions occurring after the date these proposed regulations are published as final regulations in the **Federal Register**.

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

(Filed by the Office of the Federal Register on March 9, 2005, 8:45 a.m., and published in the issue of the Federal Register for March 10, 2005, 70 F.R. 11903)

Foundations Status of Certain Organizations

Announcement 2005–23

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

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

2nd Street Family Center, Allentown, PA

A C Dysart Park Association,
Banning, CA
ACAB Corporation and Affiliates,
New York, NY
Ace It Education, Inc., Revere, MA
ACERRP Corporation, New Hartford, NY
Addie Talbott-H L Neblett Community
Foundation, Inc., Owensboro, KY
Adele Organization, Bronx, NY
African-American Builders & Associates,
Philadelphia, PA
African American Law Enforcement
Community Center, Philadelphia, PA
Agnes Center for Education, Inc.,
Brooklyn, NY
All the Way Home, Inc., Mt. Pocono, PA
Allied Workers for the Blind of Kansas
City Missouri, Kansas City, MO
Almira Stephan Memorial Playhouse,
Inc., Meriden, CT
American Friends of YCTV, Inc.,
Washington, DC
American National Opera, Denver, CO
Amicus for Children, Inc.,
Douglasville, PA
Amistad Institute, Inc., Brooklyn, NY
Angels Reside Here, Inc., New York, NY
Angels Wings, Inc., Trenton, NJ
A N N A Foundation, Inc., Rimrock, AZ
Aquinas Institute of Rochester Scholarship
Foundation, Inc., Rochester, NY
Arlington High School Golf Booster Club,
Arlington, TX
Art of Living, Inc., Philadelphia, PA
Asociacion De Puertorriiguenos En Mai
of NJ, Camden, NJ
Assembly Productions, Inc.,
New York, NY
Association for Homeless American
Veterans, Inc., Las Vegas, NV
Association for Retarded Citizens of Pike
County, Hawley, PA
Association of Young Christians
International, Victorville, CA
Ateret Seminary of Queens, Inc.,
Flushing, NY
Baldwinsville Rotary Club Foundation,
Inc., Baldwinsville, NY
Ballet Education Parent Partnership, Inc.,
Phoenix, AZ
Barre 2000 and Beyond, Inc., Barre, VT
Bea Institute for Educational Success,
Inc., Boston, MA
Beauty for Ashes Outreach, Inc.,
Atlanta, GA
Beith Matityahu, Brooklyn, NY
Bennett Academy of Music, Inc.,
Oakland Park, FL
Berkshire Interfaith Community
Investment Fund, Incorporated,
Lenox, MA
Bethel-Laurel Hill Community
Preservation, Inc., Setauket, NY
Bethel Park Athletic Office,
Bethel Park, PA
BGRASS, Inc., Cincinnati, OH
Bloomfield Education Foundation, Inc.,
Bloomfield, CT
Blue Nile Passage, Inc., New York, NY
Bogey Bear Foundation,
Mercer Island, WA
Bolton Senior Housing Corporation,
Bolton, MA
Brasarte the Damaceno Brazilian Cultural
Exchange, Oakland, CA
Brevard County 4H Youth Foundation,
Inc., Cocoa, FL
Brian P. Stack Civic Association, Inc.,
Union City, NJ
Bridge Center for Autism, Inc.,
Cincinnati, NY
Bridges Football Club, Inc.,
New York, NY
Bristol Bandits, Inc., Avon, CT
Brookville High School Athletic Booster
Club, Lynchburg, VA
Bryon Chamberlain Foundation,
Parker, CO
BTWS Cheerleading Booster Association,
Inc., Pensacola, FL
Bulldog Conditioning Club, Inc.,
Silver Spring, MD
BWH Anesthesia Research and Education
Foundation, Inc., Boston, MA
California Area School District,
California, PA
California Sportfishing Protection
Alliance, Woodland, CA
California Youth Expeditions,
Petaluma, CA
Cameron County Junior Olympic Archery
Development Club, San Benito, TX
Candlelight Ministries, Chicago, IL
Canine Causes, Mountain View, CA
Caranet, Inc., Cincinnati, OH
Carbonaro Childrens Playground
Foundation, Inc., Valley Stream, NY
Cared Foundation, Newport Beach, CA
Caring Community Association,
Philadelphia, PA
Caring for Loved Ones, Inc.,
Long Beach, CA
Carpe Diem Equine Rescue, Inc.,
Staten Island, NY
Catholic Youth in Action, Inc.,
Lawrence, MA

Cato-Meridian Community Recreation Center Foundation, Inc., Cato, NY

Center for Education and Human Services, Brooklyn, NY

Center for International Development, Half Moon Bay, CA

Center for Sacred Partnership, Inc., Pittsburgh, PA

Central Texas Coyotes Inline Hockey Club, Copperas Cove, TX

Charitable Quest Gift Fund, Philadelphia, PA

Cherubim, Sierra Vista, AZ

Chess Education Association Foundation, Scottsdale, AZ

Chichester Education Foundation, Inc., Boothwyn, PA

Child Esteem Theatre Foundation, Redwood City, CA

Chimes PA, Inc., Exton, PA

Chinese Culture Foundation, Denville, NJ

Chisholm Trail Convention, Round Rock, TX

Christian Charitable Childrens Fund of Kazakhstan Titiana Corporation, Bolton, MA

Christian East African and Equitorial Development Trust, Grove City, PA

Christian Evangelistic Ministries, San Antonio, TX

Christmas Wish Org., Brooklyn, NY

Chrysalis Residential and Community Support, Inc., Brewer, ME

Church of Jesus Christ Itnaelc, Folsom, AZ

Cithara Women's Chorale, Camp Hill, PA

Citizens Council on Affordable Higher Education, Inc., Holmdel, NJ

Citizens for Life, Saugus, MA

Coalition Against Negligent Absentee Parents International, Niagara Falls, NY

Coexistence Initiative, Inc., New York, NY

Coghill Foundation, Inc., Littleton, CO

Colonade Ministries, Cincinnati, OH

Colorado School Parent Teacher Organization, Muscatine, IA

Common Sense Foundation, Richmond, VA

Commonwealth Cyber School, Lancaster, PA

Community & Neighborhood Fund of Greater Richmond, Richmond, VA

Community Christian School, Westfield, MA

Community Health Access Project, Inc., Hawthorne, CA

Community Playhouse Corporation, Ewing, NJ

Complementary and Alternative, Colorado Springs, CO

Composers Group International, Inc., New York, NY

Comprehensive Family Counseling, Inc., Baltimore, MD

Concord Center, Omaha, NE

Conductive Education of the Greater Philadelphia Area, Strafford, PA

Connexion, Inc., Iron River, MI

Corpus Christi A & WMA, Corpus Christi, TX

Countryside High School Cheerleading Booster Club, Clearwater, FL

County Ventura Irish-American Cultural Foundation, Ventura, CA

Creating Entrepreneur Opportunities, San Diego, CA

Crisis Alcohol & Drug Abuse Center of Scotland Co., Inc., Laurinburg, NC

Daley Foundation, Jamaica, NY

Darlenes Support Group & Animal Rescue, Vancouver, WA

Davison Business Professional Womens Service Club, Davison, MI

DBMS Drill Team Booster Club, Wildomar, CA

Delta Regional Foundation, Cleveland, MS

Designs for Living Ministries, Danville, PA

Devine Intervention in America, Woodland Hills, CA

DFW Tejanos Soccer Club, Arlington, TX

Diman Alumni Association, Incorporated, Fall River, MA

Dimitri House, Inc., Rochester, NY

Disabled Veterans Helping Veterans, Elephant Butte, NM

Duxbury Recreation Foundation, Inc., Duxbury, MA

Earlville Community Center, Inc., Earlville, NY

East River Sailing Camp, North, VA

Eatontown Foundation for Excellence in Education, Inc., Eatontown, NJ

Educational Funding Services, Inc., Mission Viejo, CA

Erasmus Foundation, Inc., Potomac, MD

Eric Fund, Inc., Huntington, NY

ETA TAU Chapter of Sigma Alpha Sorority, Long Beach, CA

EVCAP, Lake Elsinore, CA

Evelyn Douglin Center for Childrens Services, Inc., Brooklyn, NY

Every Life Counts, Inc., Brooklyn, NY

FAAAS, Inc., Centerville, MA

Faces Project, Stafford, VA

F A I R Fairness Advocates for Intergenerational Rights, Philadelphia, PA

Fall River Group Homes, Inc., Kingston, MA

Family Assistance Ministries, San Clemente, CA

Family Health Alliance, Inc., Philadelphia, PA

Field Band Foundation, Inc., Johannesburg, South Africa

Filmaid, Seattle, WA

Findley Lake Nature Center, Findley Lake, NY

Fish and Chips, Fairfield, OH

Five Acre School Parent Service Organization, Inc., Carlsborg, WA

For the Love of Health Education and Humanity, Washington, DC

Fort Hill Avenue, Inc., Lynn, MA

Fort Irwin Middle School Booster Club, Fort Irwin, CA

Foster-King Dance Collection, San Diego, CA

Foundation for Local Churches and Charities, Little Valley, NY

Foundation for West Virginia, Inc., Shenandoah Junction, WV

Fountain Youth Ministries, Inc., Tucson, AZ

Free Foundation, Inc., Durham, NC

Freire Center a Popular Education Center for Democratic Change, Minneapolis, MN

Friends of Anna, Inc., Staten Island, NY

Friends of Lakeway, Littleton, NH

Friends of Lock One Conestoga Navigation Co. 1826, Lancaster, PA

Friends of Massapequa Preserve, Inc., Massapequa, NY

Friends of Plymouth Bay House, Inc., Plymouth, MA

Friends of Santa Ana Parks Recreation & Community Services, Santa Ana, CA

Friends of the Burn Center, Inc., Miami, FL

Friends of the Camden Library, Inc., Camden, NJ

Friends of the Clock Tower, Biddeford, ME

Friends of the Francis A. Gregory Regional Library, Washington, DC

Full Cry Husky Rescue, Inc., Kings Park, NY

Future Partners, San Francisco, CA

Galveston Brain Injury Association,
Galveston, TX

George Koonce, Sr. Foundation,
New Bern, NC

Georgia Injured Workers Union, Inc.,
Atlanta, GA

Germantown House Development
Corporation, Inc., Philadelphia, PA

Girls Adults Boys Seniors Organization,
Cula Vista, CA

Glacial Lakes Pheasant Restoration,
Roslyn, SD

Go Venture, Inc., Anthony, NM

Gold View Health Center Corp.,
Roswell, GA

Good Company, Inc., Atlanta, GA

Govenor Livingston High School
Hockey Boosters Association, Inc.,
Berkeley Heights, NJ

Greater New Bedford Career Educator
Partnership, Inc., New Bedford, MA

Greater Smithtown Educational
Foundation, Smithtown, NY

GSN Foundation, Reno, NV

Habonim Dror Camp Na Aleh, Inc.,
New York, NY

Hackettstown Rotary Foundation, Inc.,
Hackettstown, NJ

Hancock Creek Elementary School PTO,
Inc., N. Fort Myers, FL

Hancock Park Garden Club,
Los Angeles, CA

Hanover Senior Community, Inc.,
Washington, DC

Harambee Community Development
Corporation, Lilburn, GA

Hatboro Fire and Rescue Company,
Horsham, PA

Haverhill Affordable Residence Trust,
Inc., Haverhill, MA

Hawaii Kai Educational Foundation,
Honolulu, HI

Healthy Parenting Program, Bronx, NY

Healthy Solutions, Inc., Mount Holly, NJ

Heart of Texas-Hico, Dallas, TX

Heart of Texas-Kilgore, Inc., Dallas, TX

Heartfelt Enterprises, Inc.,
Huntington Beach, CA

Helix Choral Booster, La Mesa, CA

Helping Hands Recovery Ministries,
Atascadero, CA

Her Hearts Wish, Encinitas, CA

Hermudad En San Miguel, Bronx, NY

Highland House, Inc., New Castle, PA

Holiday Wish, Wrentham, MA

Holyoke Neighborhood Networks Center,
Inc., Holyoke, MA

Home That Works, Inc., Clayton, NJ

Homeowner Education Collaborative of
Oregon, Portland, OR

House of Hope, Inc., New Haven, CT

Hummingbird Cafe, Jamul, CA

Imago Foundation, Ltd., New York, NY

Imperial Band Boosters, Imperial, CA

Imperial Valley Community Health
Organization, Imperial, CA

Increase the Peace, Inc., Short Hills, NJ

Independent Baptist Church Planters of
America, Jacksonville, FL

Indian Orchard Main Street Partnership,
Incorporated, Indian Orchard, MA

Indiana Chapter of the American
Academy of Medical Acupuncture, Inc.,
Carmel, IN

Innovative Treatment Alternative, Inc.,
Philadelphia, PA

Insight for New Housing, Inc., Bronx, NY

Institute for the Advancement of Farming,
Kansas City, MO

Intentional Intervention Program
of Horizon Community Church,
Port St. Lucie, FL

Interlude Ministries, Inc.,
Birmingham, AL

International Organization for the Blind,
Inc., Mount Dora, FL

International Partnership for Health NFP,
Chicago, IL

International Society for Hyperbaric
Oxygenation U Cerebral,
Laud By Sea, FL

International Voice of Health Science,
Inc., Denver, CO

Islamic Family and Community Services,
Philadelphia, PA

J. Frank Dobie Band Parents Organization,
Houston, TX

Jackie Robinson Park Conservancy,
New York, NY

Jasper Childrens Theater, Inc., Jasper, AL

Jasper Endowment for Growth in
Academics, Inc., Jasper, TN

Jeffrey M. Shumake Memorial
Scholarship Fund, Inc., Strafford, PA

Jewish Identity Project of NY, Inc.,
Brooklyn, NY

Journeys in Educational Travel,
Copperas Cove, TX

Jupiter Corale, Ltd., New York, NY

Just Say Yes, Inc., Memphis, TN

Kahal Yisreal International,
New York, NY

Kappel Film Production Association,
Wonder Lake, IL

Katie B. Jackson Resident Council, Inc.,
Philadelphia, PA

Kenton Conservancy, Inc., Covington, KY

Kids 2000, Dayton, OH

Kids Company, Inc., New Richmond, WI

Kidsters, Inc., Reading, PA

Kingdom of Allah, Minneapolis, MN

Kingsborough Community College
Alumni Association, Inc., Mineola, NY

Konocti Music Foundation,
Lower Lake, CA

Korean-American Family Love
Counseling Center, Inc., Flushing, NY

Lake Region Community Concert
Association, Devils Lake, ND

Launch, Inc., Atlanta, GA

Lifeline Community Christian Center,
Inc., Clearwater, FL

Lions Clubs Diabetes Education Center,
Inc., Mineola, NY

Little Peoples Music, Inc., Oreland, PA

Living Stone Foundation, Inc.,
Leominster, MA

Loading Zone Theatre, Inc.,
New York, NY

Lord Jesus Christ Out Reach Ministries,
Deltona, FL

Love Faith 3 Hope Ministries,
Decatur, GA

Lowcountry Region of the South
Carolina National Heritage Corridor,
Charleston, SC

Lower West Side Community Enrichment
Center, Inc., Buffalo, NY

Lowndes Interagency Coordinating
Council, Inc., Valdosta, GA

MAARS Musicians and Artists Against
Rape, Winston-Salem, NC

Madrigal Wellness & Study Center, Inc.,
Perkinsville, VT

Mahelona Medical Center Charitable
Foundation, Kapaa, HI

Marine Cadet Corps, Attleboro, MA

Marlboro Educational Foundation,
Incorporated, Marlboro, NJ

Mary Jane Combemale Memorial
Foundation, Inc., Warrenton, VA

Mass Community Health Services, Inc.,
Brockton, MA

Mass211, Inc., Worcester, MA

Massachusetts First Vote Corporation,
Boston, MA

Masterworks Center, San Diego, CA

Max Field Center, Inc., Brooklyn, NY

McHenry Police Officers Charitable
Association, Inc., McHenry, IL

Memphis Hope Center Healthcare, Inc.,
Memphis, TN

Mentoring Coalition of San Diego County,
Encinitas, CA

Meor Yitzchak, Brooklyn, NY
Metropolitan Child Services, Inc.,
Brooklyn, NY
Mets All Stars, Garland, TX
Miama Foundation, Millwood, NY
Miami City Mission Youth Center, Inc.,
Miami, FL
Middle School of the Arts Foundation,
Inc., West Palm Beach, FL
Minnesota Section of the Optical Society
of America, Stillwater, MN
Minority Artist Association, Syracuse, NY
Miss Willies Where Childhood Never
Ends, Inc., Atlanta, GA
Mohau Childrens Charities for South
Africa, Inc., Sandy Hook, CT
M O R E Foundation, Inc.,
Ridgefield Park, NJ
Morristown Community Development
Corporation, Morristown, NJ
Mosaic Communities, Evanston, IL
Motivational Movement, Inc.,
New York, NY
Mountain Area Youth Organization,
Oakhurst, CA
Mt. Lebanon Baptist Church Early
Learning Center, Inc., Brooklyn, NY
Mushroom Genome & Mycodiversity
Preservation Project, Olympia, WA
MX-99, Bloomington, IN
Naramake Family Resource Center,
Norwalk, CT
Natalies Wish, Inc., Crestline, CA
National Charitable Trust From Advent,
Hartford, CT
National Council of Theotokos
Communities, Inc., Mahwah, NJ
National Hispanic Business Association,
Austin, TX
National Institute for Driver Behavior,
Inc., Cheshire, CT
NC Association of Personal & Business
Coaches, Inc., Cary, NC
NCCCAEA, Inc., Morehead City, NC
Near North Civic Association,
Newark, OH
Neighborhood Connections, Inc.,
Brandon, VT
Network of Sisters & Friends, Bowie, MD
New Century Center, Martinez, CA
New Jersey Spirit, Marlton, NJ
New Millenium Cultural and Art
Foundation, Inc., N. Brunswick, NY
New York Korean-American Lions Club
Charities, Inc., New York, NY
New York State School Age Care
Coalition, Inc., Albany, NY
New York Surgical Society, Inc.,
New York, NY
Newman Foundation, Inc.,
Solana Beach, CA
North American Friends of Elkabetz,
Worcester, MA
North Coast Digital Cinema Forum, Inc.,
Lyndhurst, OH
North Country Coordinated Transport,
Inc., Saranac Lake, NY
North Escambia Swim Booster Club,
Bratt, FL
Okaloosa County Readiness Coalition,
Inc., Ft. Walton, FL
On the Road to Recovery, Inc.,
Manchester, NH
Open the World, Incorporated, Wilton, CT
Operation K I D, Tempe, AZ
Optimum Resource Institute, Inc.,
Orange, CA
Orange After School Program, Inc.,
E. Barre, VT
Osho Foundation America, Inc.,
New York, NY
Otumfuo Fund, Inc., Bronx, NY
Our Lady of Victory Educational
Foundation, Inc., Gainesville, FL
Oxford Academy Foundation,
Cypress, CA
Pace Charter School of Hamilton Parent
Teacher Organization, Hamilton, NJ
Pacific Rehabilitation Industries,
Honolulu, HI
Pacific Semmba Systems, Inc.,
Alameda, CA
Pakistan Literacy Fund, New York, NY
Pancho Villa Historical Cemetery,
Ocala, FL
Parent-Child Bible Institute & Seminary,
Inc., Brooklyn, NY
Parent Mentor & Family Foundation,
Waukegan, IL
Parent Teacher Association of the Earth
School, Inc., New York, NY
Parents of Children With Food Allergies,
Inc., Natick, MA
Parents-Teachers Association of
Manhattan Center for Science and,
New York, NY
Parsippany Trackers Booster Club,
Parsippany, NJ
Passavant Memorial Homes Foundation,
Pittsburgh, PA
Peace of Mind Battered Center,
Antioch, CA
Pegram Elementary Parent-Teacher
Organization, Pegram, TN
People First of Arizona, Phoenix, AZ
Peoples Childrens Project Haiti,
Hiawatha, KS
Pettit Foundation, Inc., New York, NY
Phenix Foundation, San Bernardino, CA
Philadelphia Workforce Investment
Board, Inc., Philadelphia, PA
Phoenix Project of Northwest Ohio, Inc.,
Perrysburg, OH
Piedra Vista Football Booster Club,
Farmington, NM
Porter-Fields Empowerment Zone,
San Bernardino, CA
Portland Area Youth Center, Portland, MI
Power Cheer Panthers Association,
Louisville, KY
Powerlink, Pittsburgh, PA
Preparing for a Degree, Los Alamitos, CA
Professional People of Color Network,
State College, PA
Progress Trust, Inc., Philadelphia, PA
Project Heal, Inc., Marlton, NJ
Project Hope Mission, Asbury Park, NJ
Project New Covenant, Philadelphia, PA
Project Salud, Inc., Kennet Square, PA
Promethea Theatre Company,
Pittsburgh, PA
Prometheus Foundation, Seattle, WA
PSI Educational Foundation,
Fayetteville, AR
P-W-C Exchange Foundation for
the Prevention of Child Abuse,
Ft. Washington, PA
Qadosh Project, Chicago, IL
Quad Cities Railroad Educational
Association, East Molene, IL
Queenship of Mary Radio Corporation,
Milltown, NJ
Ramona Ag Boosters, Ramona, CA
Rebuilding Our Community, Inc.,
New Orleans, LA
Reid Christian Enrichment Center, Inc.,
Lanham Seabrook, MD
Reredos Male Vocal Ensemble,
Somerville, MA
Richmond County Enrichment
Corporation, Rockingham, NC
Right Choice Communications
International, Inc., Holly, MI
Riley House, Boston, MA
Riverside National Cemetery Memorial
Honor Detail, Riverside, CA
Rocky Point Alumni Foundation, Inc.,
Rocky Point, NY
Rose Brigade, Rosebud, TX
Rural Elders, Inc., Weed, CA
Ruth Larkey Foundation for Children
With Digestive & Nutritional Diseases,
New York, NY

Sachem Alumni Community Foundation, Ronkonkoma, NY

Samaritan Housing Foundation II, Inc., Atlanta, GA

Samaritan Housing Foundation III, Inc., Atlanta, GA

Samaritan Housing Foundation V, Inc., Waban, MA

San Luis Police Activities Athletics League, Inc., San Luis, AZ

San Luis Valley Welfare Advocates, Alamosa, CO

Saraswati Worship Foundation, Inc., Jamaica, NY

Second Chance Parrot Rescue, Robertsville, MO

Shared Perspectives on Therapies, San Francisco, CA

Shirat Moshe, Brooklyn, NY

Sindhi Association of Florida, Miami, FL

Skaneateles Splash, Inc., Skaneateles, NY

Soar 21st Century Support Organization for the Advancement, New Orleans, LA

Social Cultural Academic and Life Enrichment, Tempe, AZ

Solomons House, Inc., Swansea, MA

Songs Unlimited, Inc., Conway, AR

Soul Noodle Soup Foundation, Stone Mountain, GA

South Bronx Rhythm Revue, Inc., Bronxville, NY

South Central Region of National Council of State Garden Clubs, Inc., Alva, OK

South Hill Neighborhood Association, Grand Rapids, MI

South Tampa Softball Club, Tampa, FL

Southeast Community Business and Education Partnership, Canal Winchester, OH

Southeast Missouri Regional Community Development Corporation, Lilbourn, MO

Southern New Jersey Standards Consortium, Inc., Cherry Hill, NJ

Southern West Virginia Action for Youth, Inc., Williamson, WV

Southside Christian Charities, Inc., Jacksonville, FL

Southwest Phila Youth and Community Educational Service Center, Philadelphia, PA

Sparkling Dancers Drill Dance Team, Warren, MI

Spencer Cable Access Corporation, Spencer, MA

Sports Legacy Foundation, Pittsburgh, PA

St. Clair-Sanilac County Nurse Examiner Program, Marysville, MI

St. Peters Athletic Foundation, Inc., Jersey City, NJ

Start-A-Heart, Inc., Redondo Beach, CA

Student Volunteer Optometric Services to Humanity of Southern California, Los Angeles, CA

Suncook Soccer Club, Pembroke, NH

Supporters of the Golden Door Charter School, Inc., Jersey City, NJ

Susquehanna County Interfaith, Montrose, PA

Teaneck Charter School Community Organization, Inc., Teaneck, NJ

Telethon Italy US Foundation, New York, NY

Tennis Dream Fund, Inc., Cambridge, MA

Thomas McCarthy Foundation, Manford, CA

Timothy Mark Capers Foundation, White Plains, NY

Token Creek Watershed Association, Windsor, WI

T O P S, Inc., Memphis, TN

Toshas Gift of Love, Atlanta, GA

Toys for Girls and Boys, Inc., Cleveland, OH

Traci Hall & Company, Philadelphia, PA

Treasure Valley Youth Alliance, Inc., Boise, ID

Trinity Park Ministry, Inc., Orchard Park, NY

True Life Community Resource Center, Inc., Ocala, FL

TWM Foundation, Pittsburgh, PA

UIC Athletic Alumni Corp., Chicago, IL

UMA Foundation, Inc., Dorchester, MA

Understanding Manic Depression, Inc., New York, NY

Uniting Americas Children, Moreno Valley, CA

Universal Friends, Lombard, IL

Upper Arlington Community Orchestra, Inc., Columbus, OH

Vermont Liturgical & Music Association, Inc., Woodstock, VT

Vine Street Community Center Council, Inc., Roxbury, MA

Vista Botanical Gardens, Vista, CA

Warren Yacht Restoration Society, Warren, RI

Washburn Traveling Boys Basketball, Minneapolis, MN

Washington Park Foundation, Inc., Providence, RI

Washington State Association of the Deaf, Lakewood, WA

West Boca Travel Baseball Club, Boca Raton, FL

Winchendon Community Enrichment Foundation, Inc., Winchendon, MA

WMRC, Inc., Meadville, PA

Woman to Woman, Camdenton, MO

Women of Rejuvenate Spirit, Inc., Burlington, VT

Womens Bobsleigh Foundation, Westerville, OH

Womens Business Closet, Charlton, MA

Women's Multimedia Center, Claremont, CA

Womens New Media Alliance, Inc., Los Angeles, CA

Work 101 Development Corp., Brooklyn, NY

Workforce Partners, Inc., New Britain, CT

World for Humanity, Inc., Brooklyn, NY

Wyandanch Economic and Cultural Council, Inc., Wyandanch, NY

York County Youth Network, York, PA

York Mothers Center, Mount Wolf, PA

Young Friends of the Environment, Inc., Miami, FL

Youth 20-20 A La Palma Community Project, La Palma, CA

Youth Performing Arts Group, Inc., Richmond, VA

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

Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

Abbreviations

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

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

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

PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statement of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

Numerical Finding List¹

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2004–27 through 2004–52 is in Internal Revenue Bulletin 2004–52, dated December 27, 2004.

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