

## **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. 2006-35, page 50.**

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2006.

#### **REG-118775-06, page 73.**

Proposed regulations under sections 871 and 881 of the Code clarify how the portfolio interest rules apply with respect to interest paid to a partnership (or simple or grantor trust) that has foreign partners (or beneficiaries or owners). A public hearing is scheduled for September 7, 2006.

#### **Notice 2006-58, page 59.**

This notice provides that the Service will not treat a hotel, motel, or other establishment that otherwise satisfies the definition of "lodging facility" under section 856(d)(9) of the Code as other than a "lodging facility" if it is used to provide temporary housing to certain persons affected by Hurricane Katrina or Hurricane Rita, provided the requirements of the notice are satisfied.

#### **Notice 2006-59, page 60.**

**Disaster leave-sharing plans.** This notice describes certain leave-sharing plans under which employees may deposit leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster. For a plan that meets the requirements of this notice, the IRS will not assert that an employee who deposits leave under the plan realizes income or has wages or compensation with respect to the deposited leave, provided the plan treats payments made by the employer to a leave recipient as wages and compen-

sation. No deduction is allowed to an employee who deposits leave.

#### **Rev. Proc. 2006-32, page 61.**

**Casualty and theft losses.** This document provides individual taxpayers with safe harbor methods they may use in determining the amount of their casualty and theft loss deductions for personal-use residential real property and certain personal belongings that were damaged, destroyed, or stolen as a result of Hurricanes Katrina, Rita, or Wilma.

### **EMPLOYMENT TAX**

#### **T.D. 9266, page 52.**

Final regulations under sections 3102 and 3121 of the Code contain amendments to the employment tax regulations. The regulations provide guidance concerning the application of the Federal Insurance Contributions Act (FICA) to cash payments made for service not in the course of the employer's trade or business, for domestic service in a private home of the employer, for agricultural labor, and for service performed as a home worker within the meaning of section 3121(d)(3)(C).

**(Continued on the next page)**

Finding Lists begin on page ii.



**Notice 2006–59, page 60.**

**Disaster leave-sharing plans.** This notice describes certain leave-sharing plans under which employees may deposit leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster. For a plan that meets the requirements of this notice, the IRS will not assert that an employee who deposits leave under the plan realizes income or has wages or compensation with respect to the deposited leave, provided the plan treats payments made by the employer to a leave recipient as wages and compensation. No deduction is allowed to an employee who deposits leave.

## **ADMINISTRATIVE**

**Notice 2006–56, page 58.**

This notice supplements and modifies Notice 2006–20, 2006–10 I.R.B. 560, which, under the authority of section 7508A of the Code, postponed until August 28, 2006, deadlines for certain taxpayers affected by Hurricane Katrina. Specifically, this notice provides an additional postponement of time until October 16, 2006, for certain affected taxpayers.

**Announcement 2006–46, page 76.**

This document contains corrections to temporary regulations (T.D. 9258, 2006–20 I.R.B. 886) relating to amendments to tacking rule requirements of life-nonlife consolidated regulations, and final and temporary regulations (T.D. 9264, 2006–26 I.R.B. 1150) relating to business electronic filing and burden reduction.

**Announcement 2006–47, page 78.**

This document contains corrections to proposed regulations (REG–134317–05, 2006–26 I.R.B. 1184) relating to guidance necessary to facilitate business electronic filing and burden reduction.

# 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 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change

The adjusted applicable federal long-term rate is set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 467.—Certain Payments for the Use of Property or Services

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 482.—Allocation of Income and Deductions Among Taxpayers

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 642.—Special Rules for Credits and Deductions

Federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 1274.—Determination of Issue Price in the Case of Certain Debt Instruments Issued for Property

(Also Sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of

sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for July 2006.

## Rev. Rul. 2006-35

This revenue ruling provides various prescribed rates for federal income tax purposes for July 2006 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520. Finally, Table 6 contains the blended annual rate for 2006 for purposes of section 7872.

REV. RUL. 2006-35 TABLE 1  
Applicable Federal Rates (AFR) for July 2006

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-term</i>				
AFR	5.05%	4.99%	4.96%	4.94%
110% AFR	5.57%	5.49%	5.45%	5.43%
120% AFR	6.08%	5.99%	5.95%	5.92%
130% AFR	6.60%	6.49%	6.44%	6.40%
<i>Mid-term</i>				
AFR	5.05%	4.99%	4.96%	4.94%
110% AFR	5.57%	5.49%	5.45%	5.43%
120% AFR	6.08%	5.99%	5.95%	5.92%
130% AFR	6.60%	6.49%	6.44%	6.40%
150% AFR	7.63%	7.49%	7.42%	7.38%
175% AFR	8.92%	8.73%	8.64%	8.58%
<i>Long-term</i>				
AFR	5.29%	5.22%	5.19%	5.16%
110% AFR	5.82%	5.74%	5.70%	5.67%
120% AFR	6.36%	6.26%	6.21%	6.18%
130% AFR	6.91%	6.79%	6.73%	6.70%

REV. RUL. 2006-35 TABLE 2  
Adjusted AFR for July 2006

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	3.60%	3.57%	3.55%	3.54%
Mid-term adjusted AFR	3.81%	3.77%	3.75%	3.74%
Long-term adjusted AFR	4.43%	4.38%	4.36%	4.34%

REV. RUL. 2006-35 TABLE 3  
Rates Under Section 382 for July 2006

Adjusted federal long-term rate for the current month	4.43%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.45%

REV. RUL. 2006-35 TABLE 4  
Appropriate Percentages Under Section 42(b)(2) for July 2006

Appropriate percentage for the 70% present value low-income housing credit	8.21%
Appropriate percentage for the 30% present value low-income housing credit	3.52%

REV. RUL. 2006-35 TABLE 5  
Rate Under Section 7520 for July 2006

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest 6.0%

REV. RUL. 2006-35 TABLE 6  
Blended Annual Rate for 2006

Section 7872(e)(2) blended annual rate for 2006 4.71%

## Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Section 3121.—Definitions

26 CFR 31.3121(a)-2: *Wages; when paid and received.*

### T.D. 9266

#### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 31

#### Application of the Federal Insurance Contributions Act to Payments Made for Certain Services

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulation.

SUMMARY: This document contains final regulations relating to payments made for service not in the course of the employer's trade or business, for domestic service in a private home of the employer, for agricultural labor, and for service performed as a home worker within the meaning of section 3121(d)(3)(C) of the Internal Revenue Code (Code). These final regulations provide guidance concerning the application of the Federal Insurance Contributions Act (FICA) to these payments. These final regulations affect employers that make these

payments and employees that receive these payments. These final regulations provide guidance to assist these taxpayers in complying with the law.

**DATES: Effective Date:** These regulations are effective on June 19, 2006.

**Applicability Dates:** The regulations relating to payments made for service not in the course of the employer's trade or business and/or for service performed as a home worker within the meaning of section 3121(d)(3)(C) apply to cash remuneration paid on or after January 1, 1978. The regulations relating to payments made for domestic service in a private home of the employer apply to cash remuneration paid on or after January 1, 1994. The regulations relating to payments for agricultural labor apply to cash remuneration paid on or after January 1, 1988. The regulations relating to computation to the nearest dollar of cash remuneration for domestic service in a private home of the employer apply to cash remuneration paid on or after January 1, 1994.

**FOR FURTHER INFORMATION CONTACT:** Selvan Boominathan of the Office of Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities), (202) 622-0047 (not a toll-free call).

#### SUPPLEMENTARY INFORMATION:

##### Background

This document contains amendments to the Employment Tax Regulations (26 CFR part 31) under sections 3102, 3121(a), 3121(a)(7), 3121(a)(8), 3121(a)(10), and 3121(i) of the Code. The Federal Insurance Contributions Act (FICA) generally imposes tax on each employer and employee. Under section 3111, FICA tax is

imposed on the employer in an amount equal to a percentage of the wages paid by that employer. Under section 3101, FICA tax is also imposed on the employee in an amount equal to a percentage of the wages received by the employee with respect to employment. Section 3102 requires the employer to collect the tax imposed under section 3101 by deducting and withholding the amount of the tax from the wages as and when paid. Section 3121(a) defines wages for FICA tax purposes as all remuneration for employment unless otherwise excepted. Sections 3121(a)(7) (relating to domestic service in a private home of the employer and to service not in the course of the employer's trade or business), 3121(a)(8) (relating to agricultural labor) and 3121(a)(10) (relating to service performed as a home worker within the meaning of section 3121(d)(3)(C)) provide exceptions to the definition of wages for FICA tax purposes. Section 3121(i)(1) provides that in the case of domestic service described in section 3121(a)(7)(B), any payment of cash remuneration for such service which is more or less than a whole-dollar amount, to the extent prescribed by regulations, may be computed to the nearest dollar.

Proposed regulations (REG-104143-05, 2005-41 I.R.B. 708) under sections 3102, 3121(a), 3121(a)(7), 3121(a)(8), 3121(a)(10), and 3121(i) were published in the **Federal Register** (70 FR 50228-01) on August 26, 2005, and corrected in the **Federal Register** (70 FR 54680-01) on September 16, 2005. No written or electronic comments responding to the notice of proposed rulemaking were received. No public hearing was requested or held. Accordingly, the proposed regulations are adopted by this Treasury decision.

## Explanation of Provisions

These final regulations amend the existing regulations to reflect current law.

The final regulations relating to payments made for service not in the course of the employer's trade or business and/or to payments made for service as a home worker amend existing regulations §§31.3102-1, 31.3121(a)-2(c), 31.3121(a)(7)-1 and 31.3121(a)(10)-1 to reflect changes implemented by the Social Security Amendments of 1977 (the 1977 Act), Public Law 95-216 (91 Stat. 1509, 1555), and to be applicable to cash remuneration paid on or after January 1, 1978 (the effective date of the 1977 Act). For cash remuneration paid prior to January 1, 1978, taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The final regulations relating to payments made for domestic service in a private home of the employer amend existing regulations §§31.3102-1, 31.3121(a)-2(c), and 31.3121(a)(7)-1 to reflect changes implemented by the Social Security Domestic Employment Reform Act of 1994 (SSDERA), Public Law 103-387 (108 Stat. 4071), and to be applicable to cash remuneration paid on or after January 1, 1994 (the effective date of the SSDERA). For cash remuneration paid prior to January 1, 1994, taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The final regulations relating to payments for agricultural labor amend existing regulations §§31.3102-1, 31.3121(a)-2(c) and 31.3121(a)(8)-1 to reflect changes implemented by the Social Security Protection Act of 2004 (SSPA), Public Law 108-203 (118 Stat. 493, 536), the Omnibus Budget Reconciliation Act of 1987 (the 1987 Act), Public Law 100-203 (101 Stat. 1330, 1330-287), and the Technical and Miscellaneous Revenue Act of 1988 (the 1988 Act), Public Law 100-647 (102 Stat. 3342, 3793), and to be applicable to cash remuneration paid on or after January 1, 1988 (the effective date of the 1987 Act and the 1988 Act). For cash remuneration paid prior to January 1, 1988, taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

The final regulations relating to computation to the nearest dollar of cash re-

muneration for domestic service in a private home of the employer amend existing regulations under §31.3121(i)-1 to reflect changes implemented by the SSDERA and to be applicable to cash remuneration paid on or after January 1, 1994 (the effective date of the SSDERA). For cash remuneration paid prior to January 1, 1994, taxpayers should rely on the regulations applicable at the time such cash remuneration was paid.

## Special Analyses

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

## Drafting Information

The principal authors of these regulations are Selvan V. Boominathan and Michael A. Swim, Office of the Division Counsel/Associate Chief Counsel (Tax Exempt and Government Entities).

\* \* \* \* \*

## Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 31 is amended as follows:

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

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

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

Par. 2. Section 31.3102-1 is amended by:

1. Revising paragraph (b).

2. Redesignating paragraph (c) as paragraph (d).

3. Adding new paragraphs (c) and (e).

The additions and revision read as follows:

*§31.3102-1 Collection of, and liability for, employee tax; in general.*

\* \* \* \* \*

(b) The employer is permitted, but not required, to deduct amounts equivalent to employee tax from payments to an employee of cash remuneration to which the sections referred to in this paragraph (b) are applicable prior to the time that the sum of such payments equals—

- (1) \$100 in the calendar year, for service not in the course of the employer's trade or business, to which §31.3121(a)(7)-1 is applicable;

- (2) The applicable dollar threshold (as defined in section 3121(x)) in the calendar year, for domestic service in a private home of the employer, to which §31.3121(a)(7)-1 is applicable;

- (3) \$150 in the calendar year, for agricultural labor, to which §31.3121(a)(8)-1(c)(1)(i) is applicable;

or

- (4) \$100 in the calendar year, for service performed as a home worker, to which §31.3121(a)(10)-1 is applicable.

(c) At such time as the sum of the cash payments in the calendar year for a type of service referred to in paragraph (b)(1), (b)(2), (b)(3) or (b)(4) of this section equals or exceeds the amount specified, the employer is required to collect from the employee any amount of employee tax not previously deducted. If an employer pays cash remuneration to an employee for two or more of the types of service referred to in paragraph (b)(1), (b)(2), (b)(3) or (b)(4) of this section, the provisions of paragraph (b) of this section and this paragraph (c) are to be applied separately to the amount of remuneration attributable to each type of service. For provisions relating to the repayment to an employee, or other disposition, of amounts deducted from an employee's remuneration in excess of the correct amount of employee tax, see §31.6413(a)-1.

\* \* \* \* \*

- (e)(1) The provisions of paragraphs (a) and (d) of this section apply to any payment made on or after January 1, 1955.



(2) The provisions of paragraphs (b) and (c) of this section that apply to any payment made for service not in the course of the employer's trade or business or for service performed as a home worker within the meaning of section 3121(d)(3)(C) apply to any such payment made on or after January 1, 1978. The provisions of paragraphs (b) and (c) of this section that apply to any payment made for domestic service in a private home of the employer apply to any such payment made on or after January 1, 1994. The provisions of paragraphs (b) and (c) of this section that apply to any payment made for agricultural labor apply to any such payment made on or after January 1, 1988. For rules applicable to any payment for these services made prior to the dates set forth in this paragraph (e)(2), see §31.3102-1 in effect at such time (see 26 CFR part 31 contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

Par. 3. Section 31.3121(a)-2 is amended by:

1. Revising paragraph (c)(1).
2. Redesignating paragraphs (c)(2) and (c)(3) as paragraphs (c)(3) and (c)(4), respectively.
3. Adding new paragraph (c)(2).
4. Revising newly designated paragraph (c)(3).
5. Adding paragraph (d).

The additions and revisions read as follows:

*§31.3121(a)-2 Wages; when paid and received.*

\* \* \* \* \*

(c)(1) The first \$100 of cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for—

(i) Service not in the course of the employer's trade or business, to which §31.3121(a)(7)-1 is applicable, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that the sum of such cash payments made within such year is at least \$100; or

(ii) Service performed as a home worker within the meaning of section 3121(d)(3)(C), to which §31.3121(a)(10)-1 is applicable, shall be deemed to be paid by the employer to the

employee at the first moment of time in such calendar year that the sum of such cash payments made within such year is at least \$100.

(2) Cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for domestic service in a private home of the employer to which §31.3121(a)(7)-1 is applicable, and before the sum of the payments of such cash remuneration equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that the sum of such cash payments made within such year equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year.

(3) Cash remuneration paid, either actually or constructively, by an employer in any calendar year to an employee for agricultural labor to which §31.3121(a)(8)-1 is applicable, and before either of the events described in paragraphs (c)(3)(i) and (c)(3)(ii) of this section has occurred, shall be deemed to be paid by the employer to the employee at the first moment of time in such calendar year that—

(i) The sum of the payments of such remuneration is \$150 or more; or

(ii) The employer's expenditures for agricultural labor in such calendar year equals or exceeds \$2,500, except that this paragraph (c)(3)(ii) shall not apply in determining when such remuneration is deemed to be paid under this paragraph if such employee—

(A) Is employed as a hand-harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment;

(B) Commutes daily from his permanent residence to the farm on which he is so employed; and

(C) Has been employed in agriculture less than 13 weeks during the preceding calendar year.

\* \* \* \* \*

(d)(1) The provisions of paragraphs (a) and (b) of this section apply to any payment of wages made on or after January 1, 1955.

(2) The provisions of paragraph (c) of this section that apply to any payment of wages made for service not in the course of the employer's trade or business or for service performed as a home worker within the meaning of section 3121(d)(3)(C) apply to any such payment made on or after January 1, 1978. The provisions of paragraph (c) of this section that apply to any payment of wages made for domestic service in a private home of the employer apply to any such payment made on or after January 1, 1994. The provisions of paragraph (c) of this section that apply to any payment of wages made for agricultural labor apply to any such payment made on or after January 1, 1988. For rules applicable to any payment of wages for these services made prior to the dates set forth in this paragraph (d)(2), see §31.3121(a)-2 in effect at such time (see 26 CFR part 31 contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

Par. 4. Section 31.3121(a)(7)-1 is amended by:

1. Revising paragraphs (c)(1) and (c)(2).
2. Adding paragraphs (c)(3), (d) and (e).

The additions and revisions read as follows:

*§31.3121(a)(7)-1 Payments for services not in the course of employer's trade or business or for domestic service.*

\* \* \* \* \*

(c) *Cash payments.* (1) The term *wages* does not include cash remuneration paid by an employer in any calendar year to an employee for—

(i) Domestic service in a private home of the employer, unless the cash remuneration paid in such year by the employer to the employee for such service equals or exceeds the applicable dollar threshold (as defined in section 3121(x)) for such year; or

(ii) Service not in the course of the employer's trade or business, unless the cash remuneration paid in such year by the employer to the employee for such service equals or exceeds \$100.

(2) The tests relating to cash remuneration are based on the remuneration paid in a calendar year rather than on the remuneration earned during a calendar year.

The following example illustrates this provision:

*Example.* On March 31, 2004, employer X pays employee A cash remuneration of \$100 for service not in the course of X's trade or business. Such remuneration constitutes wages subject to the taxes even though \$10 thereof represents payment for such service performed by A for X in December 2003.

(3) In determining whether wages have been paid either for domestic service in a private home of the employer or for service not in the course of the employer's trade or business, only cash remuneration for such service shall be taken into account. Cash remuneration includes checks and other monetary media of exchange. Remuneration paid in any other medium, such as lodging, food, clothing, car tokens, transportation passes or tickets, or other goods or commodities, is disregarded in determining whether the cash-remuneration test is met. If an employee receives cash remuneration from an employer in a calendar year for both types of services the pertinent cash-remuneration test is to be applied separately to each type of service. If an employee receives cash remuneration from more than one employer in a calendar year for domestic service in a private home of the employer or for service not in the course of the employer's trade or business, the pertinent cash-remuneration test is to be applied separately to the remuneration received from each employer.

(d) *Cross references.* (1) For provisions relating to deduction of employee tax or amounts equivalent to the tax from cash payments for the services described in this section, see §31.3102-1;

(2) For provisions relating to time of payment of wages for such services, see §31.3121(a)-2;

(3) For provisions relating to computations to the nearest dollar of any payment of cash remuneration for domestic service in a private home of the employer, see §31.3121(i)-1.

(e) *Effective dates.* (1) The provisions of this section apply to any cash payment for service not in the course of the employer's trade or business made on or after January 1, 1978 and for domestic service in a private home of the employer made on or after January 1, 1994.

(2) For rules applicable to any cash payment made prior to the dates set forth in paragraph (e)(1), see §31.3121(a)(7)-1 in effect at such time (see 26 CFR part 31

contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

Par. 5. Section 31.3121(a)(8)-1 is amended by:

1. Revising paragraphs (c), (d), and (e).
2. Adding paragraph (h).

The addition and revisions read as follows:

*§31.3121(a)(8)-1 Payments for agricultural labor.*

\* \* \* \* \*

(c) *Cash payments.* (1) The term *wages* does not include cash remuneration paid by an employer in any calendar year to an employee for agricultural labor unless—

(i) The cash remuneration paid in such year by the employer to the employee for such labor is \$150 or more; or

(ii) The employer's expenditures for agricultural labor in such year equal or exceed \$2,500, except that this paragraph (c)(1)(ii) shall not apply in determining whether remuneration paid to an employee constitutes wages for agricultural labor if such employee—

(A) Is employed as a hand-harvest laborer and is paid on a piece rate basis in an operation which has been, and is customarily and generally recognized as having been, paid on a piece rate basis in the region of employment;

(B) Commutes daily from his permanent residence to the farm on which he is so employed; and

(C) Has been employed in agriculture less than 13 weeks during the preceding calendar year.

(2) The application of the provisions of paragraph (c)(1) of this section may be illustrated by the following example:

*Example.* Employer X pays A \$140 in cash for agricultural labor in calendar year 2004. X makes no other payments to A during the year and makes no other payment for agricultural labor to any other employee. Employee A is not employed as a hand-harvest laborer. Neither the \$150-cash-remuneration test nor the \$2,500-employer's-expenditures-for-agricultural-labor test is met. Accordingly, the remuneration paid by X to A is not subject to the taxes. If in 2004 X had paid A \$140 in cash for agricultural labor and had made expenditures of \$2,360 or more to other employees for agricultural labor, the \$140 paid by X to A would have been subject to tax because the \$2,500-employer's-expenditures-for-agricultural-labor test would have been met. Or, if X had paid A \$150 in cash in 2004 and made no other payments to any other employee for agricultural labor, the \$150 paid by X to A would have been subject to

tax because the \$150-cash-remuneration test would have been met.

(d) *Application of cash-remuneration test.* (1) If an employee receives cash remuneration from an employer both for services which constitute agricultural labor and for services which do not constitute agricultural labor, only the amount of such remuneration which is attributable to agricultural labor shall be included in determining whether cash remuneration of \$150 or more has been paid in the calendar year by the employer to the employee for agricultural labor. The following example illustrates this paragraph (d)(1):

*Example.* Employer X operates a store and also is engaged in farming operations. Employee A, who regularly performs services for X in connection with the operation of the store, works on X's farm when additional help is required for the farm activities. In the calendar year 2004, X pays A \$140 in cash for services performed in agricultural labor, and \$4,000 for services performed in connection with the operation of the store. X has no additional expenditures for agricultural labor in 2004. Since the cash remuneration paid by X to A in the calendar year 2004 for agricultural labor is less than \$150, the \$150-cash-remuneration test is not met. The \$140 paid by X to A in 2004 for agricultural labor does not constitute wages and is not subject to the taxes.

(2) The test relating to cash remuneration of \$150 or more is based on the cash remuneration paid in a calendar year rather than on the remuneration earned during a calendar year. It is immaterial if such cash remuneration is paid in a calendar year other than the year in which the agricultural labor is performed. The following example illustrates this paragraph (d)(2):

*Example.* Employer X pays cash remuneration of \$150 in the calendar year 2004 to employee A for agricultural labor. Such remuneration constitutes wages even though \$10 of such amount represents payment for agricultural labor performed by A for X in December 2003.

(3) In determining whether \$150 or more has been paid to an employee for agricultural labor, only cash remuneration for such labor shall be taken into account. If an employee receives cash remuneration in any one calendar year from more than one employer for agricultural labor, the cash-remuneration test is to be applied with respect to the remuneration received by the employee from each employer in such calendar year for such labor.

(e) *Application of employer's-expenditures-for-agricultural-labor test.* (1) If an employer has expenditures in a calendar year for agricultural labor and for non-agricultural labor, only the amount of

such expenditures for agricultural labor shall be included in determining whether the employer's expenditures for agricultural labor in such year equal or exceed \$2,500. The following example illustrates this paragraph (e)(1):

*Example.* Employer X operates a store and also is engaged in farming operations. Employee A, who regularly performs services for X in connection with the operation of the store, works on X's farm when additional help is required for the farm activities. In calendar year 2004, X pays A \$140 in cash for services performed in agricultural labor, and \$4,000 for services performed in connection with the operation of the store. X has no additional expenditures for agricultural labor in 2004. Since X's expenditures for agricultural labor in 2004 are less than \$2,500, the employer's expenditures for agricultural labor test is not met. The \$140 paid by X to A in 2004 for agricultural labor does not constitute wages and is not subject to the taxes.

(2) The test relating to an employer's expenditures of \$2,500 or more for agricultural labor is based on the expenditures paid by the employer in a calendar year rather than on the expenses incurred by the employer during a calendar year. It is immaterial if the expenditures are paid in a calendar year other than the year in which the agricultural labor is performed. The following example illustrates this paragraph (e)(2):

*Example.* Employer X employs A to construct fences on a farm owned by X. The work constitutes agricultural labor and is performed over the course of November and December 2003. A is not employed by X at any other time, however X does have other employees to whom X pays remuneration of \$2,000 for agricultural labor in 2003. X pays A \$140 in cash in November 2003 and \$140 in cash in January 2004, in full payment for the work. The \$140 payment to A made in November is not wages for calendar year 2003 because the \$150-cash-remuneration test is not met and X's total expenditures for agricultural labor for such year are not equal to or in excess of \$2,500. The \$140 payment to A made in January is not wages for 2004 because the \$150-cash-remuneration test is not met. However, if X pays additional remuneration to employees for agricultural labor in 2004 that equals or exceeds \$2,360, the employer's expenditures-for-agricultural-labor test will be met and the \$140 paid by X to A in 2004 will be considered wages. It is immaterial that the work was performed in 2003.

\* \* \* \* \*

(h) *Effective dates.* The provisions of this section apply to any payment for agricultural labor made on or after January 1, 1988. For rules applicable to any payment for agricultural labor made prior to January 1, 1988, see §31.3121(a)(8)-1 in effect at such time (see 26 CFR part 31 contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

Par. 6. Section 31.3121(a)(10)-1 is revised to read as follows:

*§31.3121(a)(10)-1 Payments to certain home workers.*

(a) The term *wages* does not include remuneration paid by an employer in any calendar year to an employee for service performed as a home worker who is an employee by reason of the provisions of section 3121(d)(3)(C) (see §31.3121(d)-1(d)), unless the cash remuneration paid in such calendar year by the employer to the employee for such services is \$100 or more. The test relating to cash remuneration of \$100 or more is based on remuneration paid in a calendar year rather than on remuneration earned during a calendar year. If cash remuneration of \$100 or more is paid in a particular calendar year, it is immaterial whether such remuneration is in payment for services performed during the year of payment or during any other year.

(b) The application of paragraph (a) of this section may be illustrated by the following example:

*Example.* A, a home worker, performs services for X, a manufacturer, in 2003 and 2004. In the performance of the home work A is an employee by reason of section 3121(d)(3)(C). In March 2004, A returns to X articles made by A at home from materials received by A from X in 2003. X pays A cash remuneration of \$100 for such work when the finished articles are delivered. The \$100 includes \$10 which represents remuneration for home work performed by A in 2003. The entire \$100 is subject to the taxes. Any additional cash remuneration paid by X to A in 2004 for such services is also subject to the taxes.

(c) In the event an employee receives remuneration in any one calendar year from more than one employer for services performed as a home worker of the character described in paragraph (a) of this section, the regulations in this section are to be applied with respect to the remuneration received by the employee from each employer in such calendar year for such services. This exclusion from wages has no application to remuneration paid for services performed as a home worker who is an employee under section 3121(d)(2) (see §31.3121(d)-1(c)) relating to common law employees.

(d) Cash remuneration includes checks and other monetary media of exchange. Remuneration paid in any other medium, such as clothing, car tokens, transportation passes or tickets, or other goods or

commodities, is disregarded in determining whether the \$100 cash-remuneration test is met. If the cash remuneration paid in any calendar year by an employer to an employee for services performed as a home worker of the character described in paragraph (a) of this section is \$100 or more, then no remuneration, whether in cash or in any medium other than cash, paid by the employer to the employee in such calendar year for such services is excluded from wages under this exception.

(e)(1) For provisions relating to deductions of employee tax or amounts equivalent to the tax from cash payments for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.3102-1.

(2) For provisions relating to the time of payment of wages for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.3121(a)-2.

(3) For provisions relating to records to be kept with respect to payment of wages for services performed as a home worker within the meaning of section 3121(d)(3)(C), see §31.6001-2.

(f) The provisions of this section apply to any payment for services performed as a home worker within the meaning of section 3121(d)(3)(C) made on or after January 1, 1978. For rules applicable to any payment for services performed as a home worker within the meaning of section 3121(d)(3)(C) made prior to January 1, 1978, see §31.3121(a)(10)-1 in effect at such time (see 26 CFR part 31 contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

Par. 7. Section 31.3121(i)-1 is amended as follows:

1. Redesignating the undesignated text as paragraph (a).

2. Remove the language "quarter" each place it appears and add "year" in its place in newly designated paragraph (a).

3. Adding new paragraph (b).

The addition reads as follows:

*§31.3121(i)-1 Computation to nearest dollar of cash remuneration for domestic service.*

\* \* \* \* \*

(b) The provisions of this section apply to any cash payment for domestic service in a private home of the employer made on or after January 1, 1994. For rules ap-

plicable to any cash payment for domestic service in a private home of the employer made prior to January 1, 1994, see §31.3121(i)-1 in effect at such time (see 26 CFR part 31 contained in the edition of 26 CFR parts 30 to 39, revised as of April 1, 2006).

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

Approved June 8, 2006.

Eric Solomon,  
*Acting Deputy Assistant  
Secretary of the Treasury.*

(Filed by the Office of the Federal Register on June 16, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 19, 2006, 71 F.R. 35153)

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## **Section 7520.—Valuation Tables**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

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## **Section 7872.—Treatment of Loans With Below-Market Interest Rates**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of July 2006. See Rev. Rul. 2006-35, page 50.

## Part III. Administrative, Procedural, and Miscellaneous

### Expanded Hurricane Katrina Relief for Certain Individual Taxpayers

#### Notice 2006-56

##### PURPOSE

This notice supplements and modifies Notice 2006-20, 2006-10 I.R.B. 560 (March 6, 2006), which, under the authority of section 7508A of the Internal Revenue Code, postponed until August 28, 2006, deadlines for certain taxpayers affected by Hurricane Katrina to perform the acts described in Notice 2005-73, 2005-42 I.R.B. 723 (October 17, 2005) (e.g., filing returns and other documents, payment of taxes). It has come to the IRS's attention that some affected taxpayers need additional time to complete and file individual income tax returns for 2004 and 2005. This notice provides an additional postponement of time in order for certain individual taxpayers affected by Hurricane Katrina to file a 2004 or 2005 income tax return. Specifically, this notice provides an additional postponement of time until October 16, 2006, for affected taxpayers, as described in Notice 2006-20, with respect to the following individual income tax returns: (1) 2004 individual income tax returns, originally due on April 15, 2005, for which taxpayers obtained an extension of time to file until October 15, 2005, under section 6081, and for which Notice 2006-20 postponed the due date to August 28, 2006; and (2) 2005 individual income tax returns, originally due on April 15, 2006, for which Notice 2006-20 postponed the due date to August 28, 2006. Thus, this notice defines a new group of affected taxpayers, which is a subset of affected taxpayers as described in Notice 2006-20, who are eligible for the relief provided by this notice.

##### *Extension of the Postponement Period for Certain Individual Taxpayers to File Returns*

1. Due date for 2004 individual income tax returns, which was extended to October 15, 2005, and postponed to August 28, 2006

Section 7508A authorizes the IRS to postpone deadlines for certain time-sensitive acts for up to one year for taxpayers the IRS determines are affected by a Presidentially-declared disaster. In Notice 2006-20, for affected taxpayers who had already obtained an extension of time to file a 2004 individual income tax return, the IRS postponed the due date of that return from October 15, 2005, to August 28, 2006. Thus, such affected taxpayers have not yet received the maximum one-year postponement that may be permitted under section 7508A. The IRS has determined that certain individual affected taxpayers, as described in Notice 2006-20, may be eligible for additional time to file. Thus, individual taxpayers affected by Hurricane Katrina, who obtained an extension of time to file their 2004 individual income tax returns until October 15, 2005, and who received a postponement until August 28, 2006, are granted a further postponement until October 16, 2006, to file their 2004 individual income tax return. See I.R.C. § 7503.

Under this notice, these affected taxpayers will receive an entire year of section 7508A relief from filing deadlines for 2004 individual income tax returns that had an extended due date of October 15, 2005. Under Notice 2006-20, however, these affected taxpayers already received an entire year of relief from interest and failure to pay penalties for any payment due for the 2004 tax year. Such a payment would otherwise have been due on April 15, 2005. Interest and failure to pay penalties would accrue from April 15, 2005, until August 28, 2005, but were suspended by Notice 2006-20 from August 29, 2005, through August 28, 2006, the maximum one year allowed by section 7508A. Thus, although the IRS can postpone the time to file the 2004 individual income tax return until October 15, 2006 for affected taxpayers who had already obtained an extension of time to file the 2004 individual income tax return until October 15, 2005, section 7508A does not authorize the IRS to grant an additional period of relief with respect to interest and failure to pay penalties for the 2004 tax year. If a taxpayer is unable to make a payment by August 28, 2006, for the 2004 tax year, the taxpayer can request

that the IRS grant relief from the penalty if the failure to pay is due to reasonable cause and not due to willful neglect. The waiver of the penalty would be based on the standards of section 6651.

2. Due date for 2005 individual income tax returns, originally due on April 15, 2006, which was postponed to August 28, 2006

Affected taxpayers, as described in Notice 2006-20, received a postponement of time under section 7508A from April 15, 2006, to August 28, 2006, to file their 2005 individual income tax returns. Thus, these affected taxpayers have not yet received the maximum one-year postponement that may be permitted under section 7508A to file their 2005 individual income tax returns. The IRS has determined that affected taxpayers, as described in Notice 2006-20, are granted a further postponement under section 7508A, to October 16, 2006, to file their 2005 individual income tax returns. Under section 7508A, interest and penalties will not accrue during the period. For affected taxpayers who also request an extension under section 6081 or 6161 on or before October 16, 2006, the period of time to file and/or pay may be postponed until April 15, 2007.

##### *Identifying Affected Taxpayers under this Notice*

In order to assist the IRS in identifying affected taxpayers as described in this notice, to ensure that they receive the relief to which they are entitled, affected taxpayers should mark "Hurricane Katrina" in red ink on the top of their returns. In addition, affected taxpayers may identify themselves as eligible for relief by calling the IRS Disaster Hotline at (866) 562-5227.

##### DRAFTING INFORMATION

The principal author of this notice is Dillon Taylor of the Office of Associate Chief Counsel, Procedure and Administration (Administrative Provisions and Judicial Practice Division). For further information regarding this notice, you may call (202) 622-4940 (not a toll-free call).

# Temporary Relief for Certain REITs and Taxable REIT Subsidiaries That Provide Accommodations to Persons Affected by Hurricanes Katrina and Rita

## Notice 2006-58

The Internal Revenue Service will not treat a hotel, motel, or other establishment located in the Gulf Opportunity Zone, as defined in § 1400M of the Internal Revenue Code (26 U.S.C. § 1400M), that otherwise satisfies the definition of a “lodging facility” under § 856(d)(9) as other than a “lodging facility” if it is used to provide temporary housing to certain persons affected by Hurricane Katrina or Hurricane Rita, provided the recordkeeping requirements of this notice are satisfied.

### BACKGROUND

On August 28, 2005, and August 29, 2005, the President issued major disaster declarations for the states of Florida, Alabama, Louisiana, and Mississippi as a result of Hurricane Katrina. On September 24, 2005, the President declared major disasters for the states of Louisiana and Texas as a result of Hurricane Rita. These declarations were made pursuant to the Robert T. Stafford Disaster Relief and Emergency Assistance Act, 42 U.S.C. 5121-5206.

Subsequently, the Federal Emergency Management Agency (FEMA) designated certain counties and parishes as being eligible for individual assistance (or individual and public assistance).

Certain real estate investment trusts (REITs) that own lodging facilities expressed concern that extended stays at those facilities by persons affected by these disasters may cause the REITs to fail to satisfy the income tests under §§ 856(c)(2) and (c)(3). Although rents from real property generally are treated as qualifying income for purposes of these tests, amounts received or accrued from a corporation in which the REIT owns stock are subject to special rules. Under one of these rules, if a REIT leases an interest in real property that is a qualified lodging facility to a taxable REIT subsidiary (TRS) of that REIT, then the lease payments may

qualify as rents from real property if the property is operated on behalf of the TRS by a person who is an eligible independent contractor. Section 856(d)(9)(D)(ii) provides that a “lodging facility” is a hotel, motel, or other establishment more than one-half of the dwelling units in which are used on a transient basis. Section 856 and the regulations thereunder do not define the term “transient basis”. Accordingly, the Internal Revenue Service issued Notice 2005-89, 2005-49 I.R.B. 1077, which provided that the Service will not treat an establishment that met the definition of “lodging facility” as anything other than a “lodging facility” if it was used to provide temporary housing to certain persons affected by Hurricane Katrina or Hurricane Rita, provided certain recordkeeping requirements were satisfied. Notice 2005-89 was effective for six months from its effective date, August 28, 2005.

### TRANSIENT BASIS REQUIREMENT

Due to the magnitude of the disaster, the Service has become aware of the continued need for temporary housing for certain persons affected by Hurricanes Katrina and Rita beyond February 28, 2006, the expiration date of Notice 2005-89. Accordingly, for purposes of § 856(d)(9)(D)(ii), the Service will not treat a dwelling unit within a lodging facility located in the Gulf Opportunity Zone as being used other than on a transient basis during any six month period beginning on or after February 28, 2006, through the date on which this notice expires, if the unit is used to provide shelter to (a) an individual whose principal residence for purposes of § 1033(h)(4) on August 28, 2005, was located in a covered disaster area and who has been displaced because the residence has been destroyed or damaged as a result of Hurricane Katrina or Hurricane Rita (a displaced resident); (b) employees of business entities whose principal place of business is located in a covered disaster area who have been relocated to other areas where the business entities have job openings (a displaced employee); or (c) a worker assisting in relief activities in the covered disaster area, whether or not the worker is affiliated with a recognized government or philanthropic organization (a relief worker).

A TRS that is the lessee of a hotel, motel, or other establishment and that seeks to

rely on this notice with respect to the provision of shelter to a displaced resident, displaced employee, or relief worker for any period after February 28, 2006, must keep records for each six month period in which it seeks to rely on this notice indicating the dates on which shelter was provided, and the name and address of the displaced resident, displaced employee, or relief worker. In addition, (a) with respect to a displaced employee, the TRS must keep records indicating the individual’s employer, and (b) with respect to any relief worker, the TRS must keep records indicating the name of the individual’s employer or sponsoring organization and the nature of the relief activities undertaken during the individual’s stay.

### EFFECTIVE DATE

This notice is effective February 28, 2006, and will expire on August 28, 2007.

### PAPERWORK REDUCTION ACT

The collections of information in the notice have been reviewed and approved by the Office of Management and Budget (OMB) in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1977.

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

The collections of information in the notice are in the section of this notice entitled “Transient Basis Requirement”. The collections of information are required for compliance with § 856(d)(9)(D). The collections of information are required to obtain a benefit. The likely respondents are corporations.

The estimated total annual reporting burden is 500 hours.

The estimated annual burden per respondent varies from 25-75 hours, depending on the circumstances, with an average of 50 hours. The estimated number of respondents is 10.

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

## DRAFTING INFORMATION

The principal author of this notice is Jonathan D. Silver of the Office of Associate Chief Counsel (Financial Institutions & Products). For further information regarding this notice, contact Mr. Silver at (202) 622-3930 (not a toll-free call).

# Amounts Paid Pursuant to a Leave-Sharing Plan to Assist Employees Affected by a Major Disaster Declared by the President of the United States

## Notice 2006-59

### PURPOSE

This notice provides guidance on the federal tax consequences of certain leave-sharing plans that permit employees to deposit leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster, as defined herein.

### BACKGROUND

Section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act (Stafford Act), 42 U.S.C. § 5170, provides that the President may declare an event a major disaster. The President also may determine that the major disaster warrants individual assistance or individual and public assistance from the federal government under the Stafford Act. See, e.g., 42 U.S.C. § 5170b.

Section 9004 of Pub. L. No. 105-18, 5 U.S.C. § 6391, provides that in the event of a major disaster or emergency, as declared by the President, that results in severe adverse effects for a substantial number of employees, the President may direct the Office of Personnel Management to establish a leave-sharing plan for federal employees who are adversely affected by the disaster or emergency.

Section 61(a) of the Internal Revenue Code provides that, except as otherwise provided by law, gross income means all income from whatever source derived.

Under the facts of Rev. Rul. 90-29, 1990-1 C.B. 11, an employer establishes

a leave-sharing plan under which employees who suffer "medical emergencies" may qualify as recipients of leave surrendered to the employer, or deposited in an employer-sponsored leave bank, by other employees. The ruling concludes that the amounts the employer pays to a leave recipient pursuant to the plan are includible in the gross income of the recipient under § 61 as compensation for services provided by that recipient to the employer, and "wages" for purposes of the Federal Insurance Contributions Act (FICA), the Federal Unemployment Tax Act (FUTA), the Railroad Retirement Tax Act (RRTA), the Railroad Unemployment Repayment Tax (RURT), and income tax withholding, unless excluded therefrom under a specific provision of the Code. The ruling also concludes that an employee who surrenders leave to the employer or deposits leave in the leave bank pursuant to the plan does not realize any income or incur any deductible expense or loss upon the surrender or deposit of the leave or its use by the recipient. The ruling also states that its conclusions and rationale apply only to *bona fide* employer-sponsored leave-sharing arrangements.

### DEFINITIONS

*Major disaster* means (a) a major disaster as declared by the President under § 401 of the Stafford Act, 42 U.S.C. § 5170, that warrants individual assistance or individual and public assistance from the federal government under that Act, or (b) a major disaster or emergency as declared by the President pursuant to 5 U.S.C. § 6391, in the case of employees described in that statute.

*Major disaster leave-sharing plan* means a plan that meets the requirements of this notice.

*Leave donor* means a current employee of the employer whose voluntary written request to deposit leave in a leave bank under a major disaster leave-sharing plan is approved by the employer.

*Leave recipient* means a current employee for whom the employer has approved an application to receive leave under a major disaster leave-sharing plan.

*Family member* means any family member as defined by the major disaster leave-sharing plan.

## MAJOR DISASTER LEAVE-SHARING PLAN

For purposes of this notice, a major disaster leave-sharing plan is a written plan meeting each of the following requirements:

1. The plan allows a leave donor to deposit accrued leave in an employer-sponsored leave bank for use by other employees who have been adversely affected by a major disaster. For purposes of the plan, an employee is considered to be adversely affected by a major disaster if the disaster has caused severe hardship to the employee or a family member of the employee that requires the employee to be absent from work.

2. The plan does not allow a leave donor to deposit leave for transfer to a specific leave recipient.

3. The amount of leave that may be donated by a leave donor in any year generally does not exceed the maximum amount of leave that an employee normally accrues during the year.

4. A leave recipient may receive paid leave (at his or her normal rate of compensation) from leave deposited in the leave bank. Each leave recipient must use this leave for purposes related to the major disaster.

5. The plan adopts a reasonable limit, based on the severity of the disaster, on the period of time after the major disaster occurs during which a leave donor may deposit the leave in the leave bank, and a leave recipient must use the leave received from the leave bank.

6. A leave recipient may not convert leave received under the plan into cash in lieu of using the leave. However, a leave recipient may use leave received under the plan to eliminate a negative leave balance that arose from leave that was advanced to the leave recipient because of the effects of the major disaster. A leave recipient also may substitute leave received under the plan for leave without pay used because of the major disaster.

7. The employer must make a reasonable determination, based on need, as to how much leave each approved leave recipient may receive under the leave-sharing plan.

8. Leave deposited on account of one major disaster may be used only for employees affected by that major disaster.

ter. Except for an amount so small as to make accounting for it unreasonable or administratively impracticable, any leave deposited under a major disaster leave-sharing plan that is not used by leave recipients by the end of the period specified in paragraph 5, above, must be returned within a reasonable period of time to the leave donors (or, at the employer's option, to those leave donors who are still employed by the employer) so that the donor will be able to use the leave. The amount of leave returned to each leave donor must be in the same proportion as the amount of leave donated by the leave

donor bears to the total amount of leave donated on account of that major disaster.

**GUIDANCE**

The IRS will not assert that a leave donor who deposits leave in an employer-sponsored leave bank under a major disaster leave-sharing plan realizes income or has wages, compensation, or rail wages with respect to the deposited leave, provided that the plan treats payments made by the employer to the leave recipient as "wages" for purposes of FICA, FUTA, and income tax withholding, and as "compensation" for purposes of RRTA and "rail

wages" for purposes of RURT, unless excluded therefrom under a specific provision of the Code. A leave donor may not claim an expense, charitable contribution, or loss deduction on account of the deposit of the leave or its use by a leave recipient.

**DRAFTING INFORMATION**

The principal author of this notice is Shareen S. Pflanz of the Office of Associate Chief Counsel (Income Tax & Accounting). For further information regarding this notice, contact Shareen S. Pflanz at (202) 622-4920 (not a toll-free call).

*26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, §§ 165, 1400M, 1400S; 1.165-7(a)(2), 1.165-7(b), 1.165-8(c).)*

**Rev. Proc. 2006-32**

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**SECTION 1. PURPOSE**

.01 This revenue procedure provides safe harbor methods that individual taxpayers may use in determining the amount of their casualty and theft loss deductions pursuant to § 165 of the Internal Revenue Code for their personal-use residential real property (as defined in section 3.02 of this revenue procedure) and personal belongings (as defined in section 3.03 of this revenue procedure) damaged, destroyed, or stolen as a result of Hurricanes Katrina, Rita, and Wilma (“the 2005 Gulf hurricanes”). Specifically, this revenue procedure provides three safe harbor methods that individuals may use to determine the decrease in fair market value of personal-use residential real property. This revenue procedure also provides a fourth safe harbor method that individuals may use to determine the fair market value of their personal belongings immediately before the 2005 Gulf hurricanes.

.02 The Internal Revenue Service will not challenge an individual’s determination of the decrease in fair market value of personal-use residential real property attributable to one of the 2005 Gulf hurricanes if the individual qualifies for and uses one of the safe harbor methods described in section 4 of this revenue procedure. Furthermore, the IRS will not challenge an individual’s determination of the fair market value of personal belongings immediately before one of the 2005 Gulf hurricanes if the individual qualifies for and uses the safe harbor method described in section 7 of this revenue procedure.

.03 Finally, this revenue procedure requires that if an individual uses the Cost

Indexes Safe Harbor Method described in section 4.04 of this revenue procedure, the individual also must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

.04 Use of a safe harbor method described in this revenue procedure is not mandatory. An individual may, instead, use the actual reduction in the fair market value of personal-use residential real property or personal belongings, pursuant to § 1.165–7(a)(2) of the Income Tax Regulations, if the individual has proper substantiation.

.05 The safe harbor methods provided in this revenue procedure apply only to the circumstances within the scope of this revenue procedure and may not be used in any other circumstances.

**SECTION 2. BACKGROUND**

.01 Section 165(a) generally provides that a taxpayer may deduct any loss sustained during the taxable year and not compensated for by insurance or otherwise. With respect to property not connected with a trade or business or a transaction entered into for profit, § 165(c)(3) limits an individual taxpayer’s deductions to losses arising from fire, storm, shipwreck, or other casualty, or from theft.

.02 Section 165(h) imposes two limitations on casualty and theft loss deductions for property not connected with a trade or business or transaction entered into for profit. Section 165(h)(1) provides that any loss to an individual described in § 165(c)(3) shall be allowed only to the extent that the amount of the loss arising from each casualty, or from each theft, exceeds

\$100. Section 165(h)(2) provides that if personal casualty and theft losses for any taxable year exceed personal casualty and theft gains for the taxable year, the losses are allowed only to the extent of the sum of the amount of the gains, plus so much of the excess as exceeds ten percent of the adjusted gross income of the individual.

.03 Section 1400M(2) defines “Hurricane Katrina disaster area” as an area with respect to which a major disaster has been declared by the President before September 14, 2005, under § 401 of Robert T. Stafford Disaster Relief and Emergency Assistance Act (“Stafford Act”) (42 USC § 5170) by reason of Hurricane Katrina. The Hurricane Katrina disaster area covers the entire states of Alabama, Florida, Louisiana, and Mississippi. Section 1400M(4) defines “Hurricane Rita disaster area” as an area with respect to which a major disaster has been declared by the President before October 6, 2005, under § 401 of the Stafford Act by reason of Hurricane Rita. The Hurricane Rita disaster area covers the entire states of Louisiana and Texas. Section 1400M(6) defines “Hurricane Wilma disaster area” as an area with respect to which a major disaster has been declared by the President before November 14, 2005, under § 401 of the Stafford Act by reason of Hurricane Wilma. The Hurricane Wilma disaster area covers the entire state of Florida.

.04 Section 1400S(b) suspends the limitations on personal casualty and theft loss deductions imposed by § 165(h) if the losses are attributable to the applicable 2005 Gulf hurricane and arose in the (1) Hurricane Katrina disaster area on or after August 25, 2005, (2) Hurricane Rita disas-

ter area on or after September 23, 2005, or (3) Hurricane Wilma disaster area on or after October 23, 2005.

.05 Section 1.165-1(c)(4) provides that in determining the amount of loss sustained, adjustments must be made for any insurance or other compensation received.

.06 Section 1.165-7(b) provides that the amount of a casualty loss is the lesser of (1) the difference between the fair market value of the property immediately before the casualty and the fair market value immediately after the casualty, or (2) the adjusted basis of the property. Section 1012 and § 1.1012-1(a) provide that the basis of property generally is its cost. Section 1016(a)(1) and § 1.1016-2(a) provide that the basis of property is adjusted for any expenditure, receipt, loss, or other item, properly chargeable to capital account, including the cost of improvements and betterments made to the property.

.07 Section 1.165-7(a)(2)(i) provides that to determine the amount of the deductible loss under section 165(a), the fair market value of the property immediately before and immediately after the casualty generally shall be ascertained by competent appraisal. Section 1.165-7(a)(2)(ii) provides that the cost of repairs to the property damaged is acceptable as evidence of the decrease in value of the property if the taxpayer shows that: (1) the repairs are necessary to restore the property to its condition immediately before the casualty; (2) the amount spent for such repairs is not excessive; (3) the repairs do not care for more than the damage suffered; and (4) the value of the property after the repairs does not, as a result of the repairs, exceed the value of the property immediately before the casualty. In order to use the cost-of-repairs method to determine the decrease in fair market value, the taxpayer must actually make the repairs rather than rely on estimates of repairs that will be performed in the future or not at all. *See Lamphere v. Commissioner*, 70 T.C. 391, 396 (1978), *acq.*, 1978-2 C.B. 2; *Farber v. Commissioner*, 57 T.C. 714, 719 (1972), *acq.*, 1972-2 C.B. 2.

.08 Section 1.165-8(c) provides that the amount deductible in the case of a theft loss is determined consistently with the manner described in § 1.165-7 for determining the amount of a casualty loss. The fair market value of the property immediately after the theft is considered to be zero.

.09 Section 1.165-7(b)(2)(ii) provides that in determining a casualty loss involving real property and improvements thereon not used in a trade or business or in any transaction entered into for profit, the improvements (such as buildings and ornamental trees and shrubbery) to the property damaged or destroyed are considered an integral part of the property, and no separate basis need be apportioned to the improvements.

.10 Due to the widespread devastation from the 2005 Gulf hurricanes, it may be difficult for individuals to determine the decrease in the fair market value of damaged, destroyed, or stolen property using the methods provided in § 1.165-7(a)(2). The IRS and Treasury Department recognize that the statutory suspension of § 165(h) limitations on 2005 Gulf hurricane casualty loss deductions provided by § 1400S reflects Congressional intent to facilitate certain deductions. In view of these unique circumstances, the IRS and Treasury Department believe it is appropriate to provide safe harbor methods for use in determining the amount of casualty and theft loss deductions for certain property damaged, destroyed, or stolen as a result of the 2005 Gulf hurricanes. Therefore, this revenue procedure provides safe harbor methods that individuals may use under § 1.165-7(a)(2)(i) to measure the decrease in the fair market value of their personal-use residential real property that was damaged or destroyed and to determine the pre-hurricane fair market value of personal belongings that were damaged, destroyed, or stolen as a result of one of the 2005 Gulf hurricanes.

### SECTION 3. SCOPE

.01 *In general.* An individual who suffered a casualty or theft loss for the individual's personal-use residential real property or personal belongings damaged, destroyed, or stolen as result of the 2005 Gulf hurricanes may use the safe harbor methods provided in this revenue procedure in determining the amount of the individual's casualty and theft loss deductions under § 165.

.02 *Definition of personal-use residential real property and personal residence.* For purposes of this revenue procedure, personal-use residential real property is real property, including improvements

(such as buildings and ornamental trees and shrubbery) that is owned by the individual who suffered a casualty loss, that contains at least one personal residence, and that is not used in a trade or business or in a transaction entered into for profit. Personal-use residential real property does not include rental property. For purposes of this revenue procedure, a personal residence is a single family residence, or a single unit within a contiguous group of attached residential units (for example, a townhouse or duplex), owned by the individual who suffered a casualty loss, and consists of the total enclosed square footage of the residence or single unit, including any enclosed structures attached to the residence or single unit. For example, a personal residence includes a basement and an attached garage, but does not include a deck or screened-in porch. For purposes of this revenue procedure, a personal residence does not include a condominium or cooperative unit, or any other property for which the individual who suffered the casualty loss does not own the structural components of the building (such as the foundation, walls, and roof), or owns only a fractional interest in all of the structural components of the building, or a mobile home or trailer.

.03 *Definition of personal belongings.* For purposes of this revenue procedure, a personal belonging is an item of tangible personal property that is owned by the individual who suffered a casualty or theft loss and that is not used in a trade or business or in a transaction entered into for profit. For purposes of this revenue procedure, personal belongings do not include a boat, aircraft, mobile home, trailer, or vehicle (as defined in section 7.02 of this revenue procedure), or an antique or other asset that maintains or increases its value over time.

.04 *Use of three personal-use residential real property safe harbor methods.* An individual described in section 3.01 of this revenue procedure may use any of the three safe harbor methods described in section 4 of this revenue procedure to determine the decrease in fair market value for personal-use residential real property located in the Hurricane Katrina disaster area, Hurricane Rita disaster area, or Hurricane Wilma disaster area (see section 2.03 of this revenue procedure) that was

damaged or destroyed as a result of one or more of the 2005 Gulf hurricanes. The three personal-use residential real property safe harbor methods are the Insurance Safe Harbor Method described in section 4.02 of this revenue procedure, the Contractor Safe Harbor Method described in section 4.03 of this revenue procedure, and the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure.

*.05 Use of Cost Indexes Safe Harbor Method.* An individual may use the Cost Indexes Safe Harbor Method if the individual's personal-use residential real property has suffered, in the circumstances described below, (1) a total loss of a personal residence, (2) a near total loss of a personal residence, (3) interior flooding over 1 foot of a personal residence, (4) structural damage from wind, rain, or debris to a personal residence, (5) roof covering damage from wind, rain, or debris to a personal residence, (6) damage to a detached structure, or (7) damage to wood decking:

(1) *Total loss.* A total loss of a personal residence occurs if, as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one of the 2005 Gulf hurricanes, any one of the following occurred:

(a) The personal residence either collapsed or is structurally unsound (for example, the structural connections in the personal residence, such as nails and anchor bolts, have corroded as a result of prolonged exposure to salt water (including brackish water) over an extended period of time to the extent that they compromise the structural integrity of the personal residence);

(b) The state or local government or any political subdivision thereof has ordered that the personal residence be demolished or relocated;

(c) The individual has sold the personal residence to an unrelated party for a price that reflects the fair market value solely of the land on which the personal residence is situated; or

(d) The personal residence sustained damage that satisfies the definition of near total loss, as described in section 3.05(2) of this revenue procedure, and the individual has demolished the personal residence.

(2) *Near total loss.* The near total loss of a personal residence occurs if, as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one or more of the 2005 Gulf hurricanes, the personal residence sustained severe damage necessitating the removal and disposal of substantially all interior wall frame coverings (including drywall and other wall frame coverings), floorings, electrical lines, ducts, plumbing, and other fixtures. For a personal residence sustaining near total loss, only the wood frame, rafters, and outside façade of the personal residence remain structurally sound and reusable.

(3) *Interior flooding over 1 foot.* Interior flooding over 1 foot occurs if a personal residence was flooded with salt water (including brackish water) to a height of more than 1 foot as a result of a storm surge or catastrophic prolonged flooding due to breaching or overtopping of a protective levee system during one or more of the 2005 Gulf hurricanes, but did not sustain damage that falls within the definition of total loss or near total loss, as described in section 3.05(1) and (2) of this revenue procedure.

(4) *Structural damage from wind, rain, or debris.* Structural damage from wind, rain, or debris occurs if a personal residence sustained major structural damage to the roof and/or outside wall(s) as a result of wind or windblown debris from one or more of the 2005 Gulf hurricanes that exposed part or all of the interior of the personal residence to rain or debris, requiring substantial renovation of the damaged areas. Substantial renovation requires the removal and replacement of drywall or other wall frame coverings, replacement of trim, and repair and painting of the damaged interior areas of the personal residence.

(5) *Roof covering damage from wind, rain, or debris.* Roof covering damage from wind, rain, or debris occurs if a personal residence sustains damage from wind, rain, or windblown debris to roofing felt, shingles, flashings, fascia, or soffit as a result of one or more of the 2005 Gulf hurricanes.

(6) *Detached structures.* A detached structure consists of a detached structure on personal-use residential real property where the detached structure sustained

damage from one or more of the 2005 Gulf hurricanes to the extent that it requires either complete or major rebuilding. A detached structure includes a shed, shop, or detached garage that is not used in connection with a trade or business and that is not equipped with heating or air conditioning. Furthermore, a detached structure is of enclosed wood-frame construction, with some electrical capabilities and little or no interior finishing.

(7) *Wood decking.* Wood decking consists of pressure treated wood decking attached to a personal residence where the decking was damaged or destroyed by one of the 2005 Gulf hurricanes.

*.06 Taking into account no-cost repairs.* An individual using the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

*.07 Use of Personal Belongings Safe Harbor Method.* An individual may use the Personal Belongings Safe Harbor Method described in section 7.01 of this revenue procedure to determine the pre-hurricane fair market value of the individual's personal belongings located in the Hurricane Katrina disaster area, Hurricane Rita disaster area, or Hurricane Wilma disaster area (see section 2.03 of this revenue procedure) that were damaged, destroyed, or stolen as a result of one of the 2005 Gulf hurricanes.

*.08 Limited use of safe harbor methods.* The safe harbor methods described in sections 4 and 7 are available only in the circumstances described in this revenue procedure.

#### SECTION 4. PERSONAL-USE RESIDENTIAL REAL PROPERTY SAFE HARBOR METHODS

*.01 In general.* An individual within the scope of this revenue procedure may use any one of the three safe harbor methods described in this section 4. If an individual owns two or more parcels of personal-use residential real property, the use of a safe harbor method for one parcel does not require the individual to use the same safe harbor method, or any safe harbor method, for any other parcel.

*.02 Insurance Safe Harbor Method.* Under the Insurance Safe Harbor Method, to determine the decrease in the fair market value of the individual's personal-use residential real property, an individual may use the estimated loss determined in reports prepared by the individual's homeowners' or flood insurance company setting forth the estimated loss the individual sustained as a result of the damage to or destruction of the individual's personal-use residential real property from one of the 2005 Gulf hurricanes.

*.03 Contractor Safe Harbor Method.* Under the Contractor Safe Harbor Method, to determine the decrease in the fair market value of the individual's personal-use residential real property, an individual may use the contract price for the repairs specified in an itemized contract prepared by a contractor, licensed or registered in accordance with State or local regulations, setting forth the costs to restore the individual's personal-use residential real property to the condition existing immediately prior to the applicable 2005 Gulf hurricane. However, the costs of any improvements or additions that increase the value of the personal-use residential real property above its pre-hurricane value, such as the cost to elevate the personal residence to meet new construction requirements, must be excluded from the contract price for purposes of this safe harbor. To use the Contractor Safe Harbor Method, the contract must be a binding contract signed by the individual and the contractor.

*.04 Cost Indexes Safe Harbor Method.*

(1) *In General.* Under the Cost Indexes Safe Harbor Method, an individual may use one or more of the cost indexes, as applicable, provided in this section 4.04 to determine the decrease in the fair market value of personal-use residential real property, including the personal residence, de-

tached structures, and wood decking. Cost indexes are provided for three size categories of personal residences based on the square footage of the personal residence.

In computing the decrease in fair market value under the Cost Indexes Safe Harbor Method, an individual must take into account the value of any no-cost repairs as described in section 6 of this revenue procedure.

If the Cost Indexes Safe Harbor Method described in this section 4.04 is used, the amount determined is the full amount of the decrease in fair market value of that personal-use residential real property, and may not be increased by amounts related to items such as landscaping, debris removal, demolition, etc.

The Cost Indexes Safe Harbor Method applies only to the following three types of improvements on an individual's personal-use residential real property: a personal residence (as described in section 3.02 of this revenue procedure), a detached structure (as described in section 3.05(6) of this revenue procedure), and a pressure treated wood deck (as described in section 3.05(7) of this revenue procedure). If there is any other type of improvement on an individual's personal-use residential real property that is not described in sections 3.02, 3.05(6) and 3.05(7) of this revenue procedure, the individual may use the Cost Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property, but may not add any amount for the other type of improvements. For example, under the Cost Indexes Safe Harbor Method, no amount may be added to the decrease in fair market value of the personal-use residential real property for a residence that contains a home office, a residence in a structure that contains five or more residential units, a detached structure

equipped with heating or air conditioning, or a deck made of synthetic material or hardwood that is not pressure treated.

(2) *Special rules for Cost Indexes Safe Harbor Method.*

(a) A personal residence may not be subject to more than one of the following tables: Table 1 (Total Loss); Table 2 (Near Total Loss); or Table 3 (Interior Flooding Over 1 Foot).

(b) A personal residence subject to Table 3 (Interior Flooding Over 1 Foot) also may be subject to Table 4 (Structural Damage From Wind, Rain, or Debris), but the square footage flooded may not be included in the square footage used for Table 4 (Structural Damage From Wind, Rain, or Debris).

(c) A personal residence subject to Table 3 (Interior Flooding Over 1 Foot) or Table 4 (Structural Damage From Wind, Rain, or Debris) may also be subject to Table 5 (Roof Covering Damage from Wind, Rain, or Debris).

(d) Table 6 (Detached Structures) and Table 7 (Wood Decking) may apply to any personal-use residential real property to which Table 1 (Total Loss), Table 2 (Near Total Loss), or Table 3 (Interior Flooding Over 1 Foot), Table 4 (Structural Damage From Wind, Rain, or Debris), or Table 5 (Roof Covering Damage From Wind, Rain, or Debris) apply.

(e) If an individual's personal-use residential real property contains more than one personal residence and the individual uses the Cost Indexes Safe Harbor Method, the individual must apply the applicable table, or combination of tables, to each personal residence.

(3) *Tables.* The following tables set forth the cost indexes for each corresponding category described in section 3.05 of this revenue procedure:

Table 1 – Total Loss

Cost Indexes – Total Loss	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	\$175
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	\$148
Large Personal Residence (Personal residence is greater than 3,000 square feet)	\$132

For a personal residence that falls within the description of a total loss in section 3.05(1) of this revenue procedure, use Table 1 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the size of the personal residence based on the total square footage described in Table 1.

(3) Multiply the total square footage of the personal residence (from step 1) by the

applicable Cost Index in column 2 of Table 1.

Table 2 – Near Total Loss

Cost Indexes – Near Total Loss	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	\$142
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	\$120
Large Personal Residence (Personal residence is greater than 3,000 square feet)	\$107

For a personal residence that falls within the description of a near total loss in section 3.05(2) of this revenue procedure, use Table 2 as follows:

(1) Determine the total square footage of the personal residence.

(2) Determine the size of the personal residence based on the total square footage described in Table 2.

(3) Multiply the total square footage of the personal residence (from step 1) by the

applicable cost index in column 2 of Table 2.

Table 3 – Interior Flooding Over 1 Foot

Cost Indexes – Interior Flooding Over 1 Foot	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	\$108
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	\$ 92
Large Personal Residence (Personal residence is greater than 3,000 square feet)	\$ 82

The cost indexes in Table 3 are applied only to the square footage of the personal residence that was flooded, rather than the total square footage.

For a personal residence that was flooded by salt water (including brackish water) to a height of greater than 1 foot, as described in section 3.05(3) of this revenue procedure, and does not fall

within the description of a total loss or near total loss in sections 3.05(1) and (2) of this revenue procedure, use Table 3 as follows:

- (1) Determine the total square footage of the personal residence.
- (2) Determine the size of the personal residence based on the total square footage described in Table 3.

(3) Determine the square footage of the flooded area of the personal residence.

(4) Multiply the flooded square footage (from step 3) by the applicable cost index in column 2 of Table 3.

Table 4 – Structural Damage From Wind, Rain, or Debris

Cost Indexes – Structural Damage From Wind, Rain, or Debris	
Percent of Damage Category	
Percent Damaged = Square Footage of Damaged Area / Total Square Footage of Personal Residence	
Percent Damaged	Cost Index per sq. ft.
15% to 25%	\$143
26% to 50%	\$132
51% to 100%	\$119

The cost indexes in Table 4 apply only to the square footage of the damaged area of the personal residence, rather than the total square footage. Personal residences that sustained 100% wind, rain, or debris damage are those that sustained major structural damage throughout the entire personal residence necessitating substantial renovation (as defined in section 3.05(4) of this revenue procedure) of all of the rooms in the personal residence.

For a personal residence that sustained structural damage from wind, rain, or debris, use Table 4 as follows:

- (1) Determine the total square footage of the personal residence.
- (2) Determine the square footage of the damaged portion of the personal residence by adding the square footage of each room needing substantial renovation.
- (3) Determine the percent of square footage of the personal residence that was

damaged by dividing the square footage that was damaged (from step 2) by the total square footage (from step 1).

(4) Multiply the square footage of the damaged area (from step 2) by the applicable cost index in column 2 of Table 4 (based on the percent of damage range in column 1 of Table 4).

Table 5 – Roof Covering Damage From Wind, Rain, or Debris

Cost Indexes – Roof Covering Damage From Wind, Rain, or Debris	
Personal Residence Size	Cost Index per sq. ft.
Small Personal Residence (Personal residence is less than 1,500 square feet)	\$6.00
Medium Personal Residence (Personal residence is between 1,500 and 3,000 square feet)	\$5.75
Large Personal Residence (Personal residence is greater than 3,000 square feet)	\$5.50

If the personal residence sustained roof covering damage from wind, rain, or debris as described in section 3.05(5) of this revenue procedure, apply the applicable cost index in Table 5 to the total square footage under the roof (including the porch, patios, and overhangs).

For a personal residence that sustained roof covering damage from wind, rain, or debris, as described in section 3.05(5) of this revenue procedure, use Table 5 as follows:

(1) Determine the total square footage of the ground floor of the personal residence.

(2) Add to the total square footage of the ground floor (from step 1) the square footage of any area of the roof that extends beyond the ground floor, such as porches and attached carports, to determine the total square footage under the roof.

(3) Determine the applicable cost index in column 2 of Table 5 based on the

total square footage of the personal residence.

(4) Multiply the total square footage under the roof (from step 2) by the applicable cost index in column 2 of Table 5 (from step 3).

Table 6 – Detached Structures

Cost Indexes – Detached Structures	
Detached Structure Size	Cost Index per sq. ft.
Up to 200 square feet	\$48
Over 200 and up to 400 square feet	\$38
Over 400 square feet	\$33

For a detached structure on personal-use residential real property, as described in section 3.05(6) of this revenue procedure, apply the applicable cost index in Table 6 as follows:

(1) Determine the total square footage of the detached structure.

(2) Determine the size of the detached structure based on the total square footage described in column 1 of Table 6.

(3) Multiply the total square footage of the detached structure (from step 1) by the applicable cost index in column 2 of Table 6.

Table 7 – Wood Decking

Cost Index – Wood Decking	
	Cost Index per sq. ft.
Use for all sizes of wood decking	\$15

For pressure treated wood decking attached to a personal residence, as described in section 3.05(7) of this revenue procedure, apply the cost index in Table 7 as follows:

(1) Determine the square footage of the damaged area of the deck.

(2) Multiply the square footage of the damaged area of the deck (from step 1) by the cost index in column 2 of Table 7.

## SECTION 5. COST INDEXES SAFE HARBOR METHOD EXAMPLES

The following examples illustrate the application of the Cost Indexes Safe Harbor Method described in section 4.04 of this revenue procedure.

*Example 1.* Prior to Hurricane Katrina, an individual purchased a personal residence for \$300,000. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structures. The personal residence was flooded by nine feet of salt water for over three weeks due to a breach in a levee, causing the structural connections in the personal residence to corrode to the extent they must be replaced. The personal residence is located in the Hurricane Katrina disaster area. Insurance and other reimbursements total \$100,000. The individual obtained from the insurance company a report setting forth the estimated damage to the personal residence. The individual also obtained from a licensed contractor a binding contract signed by the contractor and the individual itemizing the contract price to repair the damage to the personal residence. The individual chooses to use the Cost Indexes Safe Harbor Method. Because the salt water corrosion damage to the personal residence falls within the definition of total loss, as defined in section 3.05(1) of this revenue procedure, the individual uses Table 1 of the Cost Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property. The individual multiplies the square footage of the personal residence by the cost index for a Medium Personal Residence in Table 1, as follows:

$$2,000 \text{ sq. ft.} \times \$148/\text{sq. ft.} = \$296,000$$

The individual compares the decrease in fair market value, \$296,000, with the basis in the personal-use residential real property, \$300,000, and from the smaller of these two amounts, \$296,000, subtracts the insurance and other reimbursements of \$100,000. The individual is entitled to a casualty loss deduction of \$196,000 (\$296,000 - \$100,000).

*Example 2.* Assume the same facts in *Example 1*, except that the individual purchased the personal-use residential real property twenty years ago for \$120,000, and paid no additional amounts for improvements or remodeling. The individual compares the decrease in fair market value, calculated using the Cost Indexes Safe Harbor Method in *Example 1*, with the basis of the personal-use residential real property. Since the basis of \$120,000 is less than the decrease in fair market value, \$296,000, the individual's casualty loss is limited to the basis of \$120,000. Af-

ter subtracting insurance and other reimbursements of \$100,000 from the basis of \$120,000, the individual is entitled to a casualty loss deduction of \$20,000 (\$120,000 - \$100,000 = \$20,000).

*Example 3.* The individual's personal residence is substantially damaged by a storm surge from Hurricane Katrina. The individual's personal-use residential real property is located in the Hurricane Katrina disaster area. The damage falls within the definition of near total loss, as defined in section 3.05(2) of this revenue procedure, since all of the drywall, floorings, electrical lines, ducts, plumbing, and other fixtures need to be replaced. Prior to Hurricane Katrina, the individual purchased the personal-use residential real property for \$190,000 and spent \$10,000 for improvements to remodel the residence. Immediately prior to Hurricane Katrina, the adjusted basis of the property was \$200,000 (\$190,000 cost + \$10,000 improvements). The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structures. The individual paid \$5,000 to have debris cleared from the personal-use residential real property. Insurance and other reimbursements total \$100,000.

Because the damage to the personal residence falls within the definition of near total loss, the individual uses Table 2 of the Cost Indexes Safe Harbor Method to determine the decrease in fair market value of the personal-use residential real property. Using Table 2 of the Cost Indexes Safe Harbor Method, the decrease in fair market value of the personal-use residential real property is determined by multiplying the square footage of the personal residence by the cost index for a Medium Personal Residence as follows:

$$2,000 \text{ sq. ft.} \times \$120/\text{sq. ft.} = \$240,000$$

Because the individual chooses to use the Cost Index Safe Harbor Method for determining the decrease in fair market value, the \$5,000 debris removal costs are not added to the safe harbor amount of \$240,000. The individual compares the adjusted basis of the personal-use residential real property to the decrease in fair market value determined by using the Cost Indexes Safe Harbor Method. Since the adjusted basis of \$200,000 is less than the decrease in fair market value, \$240,000, the individual's casualty loss is limited to the adjusted basis of \$200,000. After subtracting \$100,000, the amount of insurance and other reimbursements received, from the adjusted basis of \$200,000, the individual is entitled to a casualty loss deduction of \$100,000 (\$200,000 - \$100,000 = \$100,000).

*Example 4.* The first floor of an individual's personal residence was flooded with 4 feet of salt water as a result of a storm surge during Hurricane Katrina. As a result of the flooding, all of the flooring and drywall on the first floor needs to be replaced. The second floor of the personal residence is not damaged. While the personal residence sustained flooding of more than 1 foot of salt water, it did not sustain damage that falls within the definition of total loss or near total loss in sections 3.05(1) and (2) of this revenue procedure. Therefore, the personal residence sustained interior flooding over 1 foot as described in section 3.05(3) of this revenue procedure. In addition, the pressure treated wood deck attached to the personal residence was completely

destroyed by Hurricane Katrina. The personal-use residential real property is located in the Hurricane Katrina disaster area. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any detached structure. The total square footage of the flooded rooms on the first floor is 1,000 square feet. Prior to Hurricane Katrina, the individual purchased the personal-use residential real property for \$200,000. Insurance and other reimbursements total \$90,000. The individual chooses to use the Cost Indexes Safe Harbor Method.

To calculate the decrease in fair market value of the personal-use residential real property, the individual uses the first column of Table 3 to determine the size of the personal residence based on the total square footage of the personal residence. The individual multiplies the flooded square footage of the personal residence, 1,000 square feet, by \$92, the cost index for a Medium Personal Residence in column 2 of Table 3.

$$1,000 \text{ sq. ft.} \times \$92/\text{sq. ft.} = \$92,000$$

The wood deck is 200 square feet.

Using Table 7, the individual multiplies the square footage of the damaged area of the deck, 200 square feet, by the cost index of \$15 in column 2 of Table 7.

$$200 \text{ sq. ft.} \times \$15/\text{sq. ft.} = \$3,000$$

To determine the total decrease in fair market value of the personal-use residential real property the individual adds \$3,000 to \$92,000.

$$\$3,000 + \$92,000 = \$95,000$$

The individual then compares the adjusted basis of the personal-use residential real property, \$200,000, to the decrease in fair market value determined by using the Cost Indexes Safe Harbor Method, \$95,000. Since the decrease in fair market value of \$95,000 is less than the basis of \$200,000, the individual's casualty loss is \$95,000. After subtracting \$90,000, the amount of insurance and other reimbursements, from \$95,000, the individual is entitled to a casualty loss deduction of \$5,000 (\$95,000 - \$90,000 = \$5,000).

*Example 5.* Prior to Hurricane Rita, an individual purchased personal-use residential real property for \$200,000 and spent \$5,000 for improvements to the personal-use residential real property. Two trees fell into the individual's personal residence during Hurricane Rita, destroying a portion of the roof. Rain from the hurricane soaked the walls and flooring of two bedrooms and the living room, necessitating removal and replacement of drywall and wood paneling, roof panels, trusses, and flooring. The rest of the personal residence remains undamaged. The personal residence was not flooded by salt water. Therefore, the damage constitutes structural damage from wind, rain, or debris, as described in section 3.05(4) of this revenue procedure. The individual's personal-use residential real property is located in the Hurricane Rita disaster area. The personal residence is 2,000 square feet and the personal-use residential real property does not contain any decking or detached structure. The damaged two bedrooms and living room total 1,000 square feet. Insurance and other reimbursements total \$100,000.



The individual chooses to use the Cost Indexes Safe Harbor Method. Using Table 4, the percentage of square footage of the personal residence that was

damaged by the hurricane is determined by dividing the total square footage of the personal residence by

the square footage of the personal residence that was damaged as follows:

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$$1,000 \text{ sq. ft.} / 2,000 \text{ sq. ft.} = 0.50 \text{ or } 50\% \text{ of the total square footage was damaged.}$$

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The individual uses the cost index in column 2 of Table 4 for 26% to 50% damage and multiplies it by the number of square feet that were damaged.

$$\$132/\text{sq. ft.} \times 1,000 \text{ sq. ft.} = \$132,000$$

The roof covering also sustained damage that necessitated replacement of all roof shingles, felt lining, and flashings. The total square footage of the ground floor of the personal residence is 2,000 square feet. The total square footage under the roof, including porches, patios, and overhangs, is 2,200 square feet. The individual multiplies the cost index for a Medium Personal Residence in Table 5 by 2,200 square feet, the total square footage under the roof.

$$2,200 \text{ sq. ft.} \times \$5.75/\text{sq. ft.} = \$12,650$$

The individual adds \$12,650 to \$132,000 to determine the total decrease in fair market value of the personal-use residential real property.

$$\$12,650 + \$132,000 = \$144,650$$

The individual compares the decrease in fair market value, \$144,650, with the adjusted basis, \$205,000, and from the smaller of these two amounts, \$144,650, subtracts insurance and other reimbursements of \$100,000. The individual is entitled to a casualty loss deduction of \$44,650 (\$144,650 - \$100,000 = \$44,650).

*Example 6.* Winds from Hurricane Rita caused a tree to fall across a detached garage located on an individual's personal-use residential real property. Prior to Hurricane Rita, the individual purchased the personal-use residential real property for \$200,000. The personal residence is located in the Hurricane Rita disaster area. The personal residence is not damaged by Hurricane Rita. The personal-use residential real property does not contain any decking or other detached structure. The garage suffered significant damage and requires major rebuilding. The total square footage of the garage is 400 square feet. The garage was not insured.

The individual chooses to use the Cost Indexes Safe Harbor Method. Because the garage is a detached structure, as described in section 3.05(6) of this revenue procedure, the individual uses Table 6 to determine the decrease in fair market value of the personal-use residential real property. Using Table 6, the individual multiplies the total square footage of the garage, 400 square feet, by the cost index of \$38 in column 2 of Table 6.

$$400 \text{ sq. ft.} \times \$38/\text{sq. ft.} = \$15,200$$

The individual's basis in the personal-use residential real property is \$200,000. The individual compares the decrease in fair market value, \$15,200, with the basis, \$200,000. Since the decrease in fair

market value is less than the basis, the individual is entitled to a casualty loss deduction of \$15,200.

*Example 7.* Winds from Hurricane Wilma blew down a pine tree that destroyed part of a pressure treated wooden deck attached to the back of an individual's personal residence. The personal-use residential real property is located in the Hurricane Wilma disaster area. The individual's basis in the personal-use residential real property is \$200,000. Neither the personal residence nor any detached structure was damaged by the fallen tree. The deck is 450 square feet. It is necessary to rebuild one-half of the deck. The remaining half of the deck is not damaged, and remains structurally sound.

The individual chooses to use the Cost Indexes Safe Harbor Method. Because the deck is wood decking as described in section 3.05(7) of this revenue procedure, the individual uses Table 7 to determine the decrease in fair market value of the personal-use residential real property.

The square footage of the damaged area of the deck is one-half of 450 square feet, which is 225 square feet. Using Table 7, the individual multiplies the square footage of the damaged area of the deck, 225 square feet, by the cost index of \$15 in column 2 of Table 7.

$$225 \text{ sq. ft.} \times \$15/\text{sq. ft.} = \$3,375$$

The individual compares the decrease in fair market value, \$3,375, with the basis, \$200,000. Since the decrease in fair market value is less than the basis, the individual is entitled to a casualty loss deduction of \$3,375.

## SECTION 6. REDUCTION FOR NO-COST REPAIRS

Under § 165(a), a casualty loss must be reduced by insurance or other amounts received, such as amounts given to an individual to repair the damage to the individual's property due to the casualty. This includes the value of repairs to, or rebuilding of, the individual's personal-use residential real property provided by another party at no cost to the individual ("no-cost repairs"), such as the repair or rebuilding of an individual's personal residence by volunteers. No-cost repairs include repairs made for a *de minimis* or token cost, donation, or gratuity.

An individual who uses the Cost Indexes Safe Harbor Method provided in section 4.04 of this revenue procedure to

determine the decrease in the fair market value of the individual's personal-use residential real property must reduce the loss, determined using the Cost Indexes Safe Harbor Method, by the value of any no-cost repairs. For this purpose, the value of a no-cost repair is based upon the total square footage completely repaired at no cost to the individual. The total square footage completely repaired at no cost to the individual is multiplied by the same cost index the individual used to determine the decrease in the fair market value of the individual's personal-use residential real property. This amount is then subtracted from the loss determined under the Cost Indexes Safe Harbor Method.

## SECTION 7. PERSONAL BELONGINGS SAFE HARBOR METHOD

.01 *Certain personal belongings.* Except as provided in section 7.02 of this revenue procedure, an individual may use the safe harbor method in this section 7.01 to determine the fair market value of the individual's personal belongings immediately before a 2005 Gulf hurricane in order to compute a casualty or theft loss. If an individual chooses to use the Personal Belongings Safe Harbor Method, the individual must apply that method to all personal belongings for which a loss is claimed under § 165 except those specifically excluded in section 7.02 of this revenue procedure.

To use this safe harbor method, an individual must first determine the current cost to replace the personal belonging with a new one and reduce that amount by 10% for each year the individual owned the personal belonging using the percentages in the Personal Belongings Valuation Table below. If the personal belonging was owned by the individual for nine or more years, the pre-hurricane fair market value is 10% of the current replacement cost under this safe harbor method.

Personal Belongings Valuation Table	
Year	Percentage of Replacement Cost to Use
1	90%
2	80%
3	70%
4	60%
5	50%
6	40%
7	30%
8	20%
9+	10%

To determine the casualty or theft loss deduction for personal belongings that were damaged, destroyed or stolen:

(1) Determine the decrease in the fair market value of each personal belonging by subtracting the fair market value of the personal belonging immediately after the hurricane from the fair market value of the personal belonging immediately before the hurricane, determined as described above. If a personal belonging was destroyed or stolen as a result of a 2005 Gulf hurricane its fair market value after the hurricane is zero.

(2) Determine the basis of each of the personal belongings (generally its cost).

(3) Compare the decrease in fair market value (from step 1) to the basis of the personal belonging (from step 2). From the lesser of the basis or decrease in fair market value, subtract any insurance or other reimbursements the individual receives or expects to receive for the personal belonging.

*.02 Exclusions.* An individual may not use the Personal Belongings Safe Harbor Method for a boat, aircraft, mobile home, trailer, vehicle, or an antique or other asset that maintains or increases its value over time. For purposes of this revenue procedure, a vehicle is an automobile, motorcycle, motor home, recreational vehicle, sport utility vehicle, off-road vehicle, van, or truck.

An individual may determine the pre-hurricane value of a boat, aircraft, mobile home, trailer, or vehicle by consulting established pricing sources. See Rev. Rul. 2002-67, 2002-2 C.B. 873.

*.03 Example.* An individual's personal belongings included a chair destroyed by Hurricane Wilma within the Hurricane Wilma disaster area. The individual purchased the chair for \$70 four years prior to Hurricane Wilma. The cost to replace the chair with a new chair is \$100. The chair is not insured.

Using the Personal Belongings Safe Harbor Method, the individual computes the fair market value of the chair immediately before the hurricane by multiplying the current replacement cost of the chair, \$100, by the applicable percentage of replacement cost from the Personal Belongings Valuation table, 60%:

$$\$100 \times 60\% = \$60$$

The individual determines the decrease in the fair market value of the chair by subtracting \$0, the fair market value of the chair immediately after the hurricane, from \$60, the fair market value of the chair immediately before the hurricane.

$$\$60 - 0 = \$60$$

The individual compares the basis of \$70 to the decrease in fair market value of \$60. Since the decrease in fair market value is less than the basis, the individual is entitled to a casualty loss deduction of \$60.

#### SECTION 8. EFFECTIVE DATE

This revenue procedure is effective for losses that arose in the (1) Hurricane Katrina disaster area on or after August 25, 2005, and are attributable to Hurricane Katrina; (2) Hurricane Rita disaster area on or after September 23, 2005, and are attributable to Hurricane Rita; and (3) Hurricane Wilma disaster area on or after October 23, 2005, and are attributable to Hurricane Wilma.

#### SECTION 9. REPORTING ON FORM 4684

Individuals who use one of the personal-use residential real property safe harbor methods provided in section 4 of this revenue procedure should attach a statement to Form 4684, *Casualties and Thefts*, stating that the individual used "Rev. Proc. 2006-32 to determine the individual's Hurricane Katrina, Rita, or Wilma (as applicable) casualty loss deduction and list the specific safe harbor method used, including the table numbers, where applicable (for example, "I/We used Rev. Proc. 2006-32 in determining my/our Hurricane Katrina casualty loss deduction using the Cost Indexes Safe Harbor Method, specifically Tables 3, 6, and 7."). Also, in completing Form 4684, if an individual uses any of the personal-use residential real property safe harbor methods in section 4 of this revenue procedure, for each of those properties do not enter an amount in line 5 or 6 and enter the decrease in fair market value determined under the safe harbor method on line 7 and mark "Revenue Procedure 2006-32" in red ink on the top of the Form 4684.

#### SECTION 10. PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-0074. Please refer to the Paperwork

Reduction Act statement accompanying Form 1040, *U.S. Individual Income Tax Return*, for further information.

#### DRAFTING INFORMATION

The principal author of this revenue procedure is Norma Rotunno of the Office of Associate Chief Counsel (Income

Tax & Accounting). For further information regarding this revenue procedure, contact Ms. Rotunno at (202) 622-7900 or Sharon Hall at (202) 622-4950 (not a toll-free call).

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Revisions to Regulations Relating to Repeal of Tax on Interest of Nonresident Alien Individuals and Foreign Corporations Received From Certain Portfolio Debt Investments

#### REG-118775-06

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations under sections 871 and 881 of the Internal Revenue Code (Code) relating to the exclusion from gross income of portfolio interest paid to a nonresident alien individual or foreign corporation. These regulations clarify how the portfolio interest rules apply with respect to interest paid to a partnership (or simple or grantor trust) that has foreign partners (or beneficiaries or owners). This document also provides notice of a public hearing.

DATES: Written or electronic comments must be received by August 13, 2006. Outlines of topics to be discussed at the public hearing scheduled for Thursday, September 7, 2006, at 10 a.m., must be received by August 24, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-118775-06), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions also may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-118775-06), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent electronically, via the IRS Internet site at [www.irs.gov/reg](http://www.irs.gov/reg) or via the Federal eRule-

making Portal at [www.regulations.gov](http://www.regulations.gov) (IRS REG-118775-06). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Jason Kleinman, (202) 622-3840; concerning the submissions of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard Hurst, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 871(a) of the Code imposes a tax of 30 percent on United States (U.S.) source fixed or determinable annual or periodic (FDAP) income received by a nonresident alien individual to the extent the amount so received is not effectively connected with the conduct of a trade or business within the U.S. Section 881(a) imposes a similar tax with respect to FDAP income received by a foreign corporation. Pursuant to these sections, U.S. source interest generally is considered FDAP income and is subject to tax. See sections 871(a)(1)(A) and 881(a)(1)(A). This tax generally is collected by means of withholding under sections 1441 and 1442, which require a payor of FDAP income to withhold 30 percent of the gross amount of such payment, unless the beneficial owner claims a reduced rate of tax on such interest under an applicable Code or treaty provision. See §§1.1441-1(b)(4) and 1.1441-6.

Notwithstanding the general imposition of tax on U.S. source interest under sections 871(a) and 881(a), sections 871(h) and 881(c), respectively, provide that no tax is imposed in the case of portfolio interest received by a nonresident individual or foreign corporation. Under section 871(h)(2) and section 881(c)(2), respectively, portfolio interest includes any interest (including original issue discount) that would be subject to tax under section 871(a) or section 881(a) but for section 871(h) or section 881(c).

However, both sections 871(h)(3)(A) and 881(c)(3)(B) provide, among other limitations, that portfolio interest does not include interest received by a 10-percent shareholder, as defined in section 871(h)(3)(B). Section 871(h)(3)(B) provides that the term 10-percent shareholder means, in the case of an obligation issued by a corporation, any person who owns 10 percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote, or, in the case of an obligation issued by a partnership, any person who owns 10 percent or more of the capital or profits interest in such partnership.

Section 871(h)(3)(C) provides that the attribution rules of section 318 apply, with three modifications, for purposes of determining whether a person is a 10-percent shareholder (the 10-percent shareholder test) of the obligor. The first modification provides that the attribution of stock from a corporation is made without regard to the 50 percent threshold set forth in section 318(a)(2)(C). The second modification provides that the attribution of stock to a corporation is made without regard to the 50 percent threshold set forth in section 318(a)(3)(C), but if a corporation would not be attributed a shareholder's stock in another corporation but for the removal of the 50 percent threshold, then the corporation is only attributed that portion of the shareholder's stock in such other corporation as the value of the shareholder's stock in the corporation bears to the value of all stock in the corporation. The third modification provides that if a person is treated as owning stock after the application of section 318(a)(4) (relating to options to acquire stock being treated as stock actually owned), then such stock shall not be treated as actually owned by such person for purposes of attributing ownership to other persons under section 318(a)(2) or (3). The flush language of section 871(h)(3) also provides that, under regulations, rules similar to the rules described above shall apply when determining the ownership of the capital or profits interest in a partnership obligor for purposes of applying the 10-percent shareholder test.

Notwithstanding the general definition of a 10-percent shareholder and the appli-

cation of section 318 described in section 871(h)(3), neither the Code nor the legislative history applicable to section 871(h)(3) specifically addresses how the 10-percent shareholder test is to apply when interest is paid to a partnership that has foreign partners. That is, neither the Code nor the legislative history explicitly provides whether the 10-percent shareholder test should be applied at the foreign partner level, the partnership level, or both levels.

## Explanation of Provisions

### 1. *In General.*

These proposed regulations address the application of the 10-percent shareholder test in section 871(h)(3) when a nonresident alien individual or foreign corporation is a partner in a partnership that is paid interest. In doing so, the proposed regulations address the two key points needed to apply the test. First, the regulations address the issue of which person “receives” interest for purposes of the 10-percent shareholder test. Second, the proposed regulations address the time at which a withholding agent must determine if the person who receives the interest is a 10-percent shareholder. Because similar issues arise with respect to interest paid to a simple trust or grantor trust, the proposed regulations also provide rules for that context.

### 2. *Person Who “Receives” Interest for Purposes of the 10-percent Shareholder Test.*

Section 871(h)(3) generally provides that interest received by a 10-percent shareholder is not considered portfolio interest exempt from taxation. When a partnership with foreign partners holds a debt instrument, the issue arises as to whether the withholding agent should apply the 10-percent shareholder test at the partner level (because such partner is the beneficial owner of the interest within the meaning of §1.1441-1(c)(6)), at the partnership level (because the partnership holds the debt instrument), or at both levels. The conclusion as to the level or levels at which the 10-percent shareholder test is applied is necessarily a conclusion as to the person or persons considered to “receive” the interest for purposes of the test. As mentioned, neither section 871(h)

nor the legislative history explicitly addresses this issue. However, the IRS and the Treasury Department have previously stated that, based upon the authority of subchapter K and the policies underlying a particular provision of the Code, a partnership may be treated as an aggregate of its partners or as an entity separate from its partners, depending on which characterization is more appropriate to carry out the purpose of the Code or regulatory provision. See T.D. 9008, 2002-2 C.B. 335 [67 FR 48020]; Rev. Rul. 89-85, 1989-2 C.B. 218; H.R. Conf. Rep. No. 2543, 83<sup>rd</sup> Cong., 2d Sess. 59 (1954); See also T.D. 9240, 2006-7 I.R.B. 454 [71 FR 2462].

After considering the alternatives, the IRS and the Treasury Department conclude that the 10-percent shareholder test should apply at the foreign partner level to the nonresident alien individual or foreign corporation that is the beneficial owner of the income. Accordingly, the proposed regulations provide that when interest is paid to a partnership, the persons who receive the interest for purposes of applying the 10-percent shareholder test are the nonresident alien individual partners and the foreign corporations that are partners in the partnership. The 10-percent shareholder test is then applied by determining each such person’s ownership interest in the obligor. No inference is intended as to whether other limitations set forth in the definition of portfolio interest should be considered at the partner level, partnership level, or at both levels (section 881(c)(3)(A)).

The approach taken in the proposed regulation is supported by the statute and legislative history which convey Congress’ desire to facilitate the efficient and effective flow of foreign capital to U.S. borrowers while distinguishing true portfolio investors in the obligor from foreign persons making direct (ten percent) equity investments in U.S. operations. See S. Rep. No. 98-169, 98 Cong., 2d Sess. 416 (1984); H.R. Rep. No. 98-861, 98 Cong., 2d Sess. 936 (1984); See also, Staff of the Joint Comm. on Tax’n, 98<sup>th</sup> Cong., General Explanation of the Revenue Provisions of the Deficit Reduction Act of 1984, at 391-394. With regard to the statute, it is clear from subchapter K, section 871, and section 881 that, in the absence of the portfolio interest exception, the tax on interest paid to a partnership is

substantively imposed on the nonresident alien individual or foreign corporation that is a partner in the partnership. That is, the beneficial owner with respect to interest paid to a partnership is the foreign partner (other than a partner that is itself a passthrough entity) and not the partnership. Based upon this fact, the IRS and the Treasury Department believe that applying the 10-percent shareholder test in section 871(h)(3) at the partner level is consistent with the statutory framework of sections 871(h)(1) and 881(c)(1) which provide that portfolio interest “received by a nonresident individual” or “received by a foreign corporation”, respectively, from sources within the U.S. is exempt from taxation under sections 871(a) and 881(a).

Further, notwithstanding the general regime for imposing tax under sections 871 and 881, the IRS and the Treasury Department do not believe that in enacting the 10-percent shareholder test, Congress intended for the test to be applied at the partnership level. Such an interpretation would condition a foreign beneficial owner’s entitlement to the portfolio interest exception on the ownership in the obligor held by either a person that is not a taxpayer (the partnership) or a person who is wholly unrelated to the beneficial owner (another partner in the partnership). The practical effect of this interpretation would be to characterize interest payments made to a partnership as being received by a 10-percent shareholder in many cases where there is no apparent abuse, thereby disallowing a tax benefit to foreign persons, and impairing the free-flow of foreign capital to U.S. business, solely because a foreign person acted indirectly rather than directly with its U.S. borrower. For example, if 100 unrelated nonresident alien individuals and foreign corporations invest in a partnership that holds 10 percent of a domestic corporation, and such domestic corporation pays U.S. source interest to the partnership, each of the foreign partners in the partnership would be denied the benefit of the portfolio interest exception if the 10-percent shareholder test is applied at the partnership level. The same result occurs if unrelated U.S. persons that are partners in the partnership hold, in combination with the partnership, 10-percent of the domestic corporate obligor. The IRS and the Treasury Department believe that

such a result is inapposite to the statutory framework and underlying purpose of the statute, especially considering that section 871(h) invokes the attribution rules of section 318 for the purpose of policing the 10-percent shareholder prohibition, and generally liberalizes the application of such rules to reach more subtle ownership arrangements.

### *3. Time When 10-percent Shareholder Test is Applied.*

Section 871(h)(3) does not explicitly provide the time at which the 10-percent shareholder test is applied. Thus, an issue arises as to whether the test is applied at the beginning of the year, on each interest payment date, at the end of the year, at all times during the year, or at some other time. Consistent with the withholding regime under sections 1441 and 1442, the proposed regulations provide that the 10-percent shareholder test is applied with respect to a nonresident alien individual or foreign corporation that is a partner in the partnership at the time that a withholding agent, absent any exceptions, would otherwise be required to withhold under sections 1441 and 1442 with respect to such interest. See §1.1441-3(b). For example, in the case of U.S. source interest paid by a domestic corporation to a domestic partnership or withholding foreign partnership (as defined in §1.1441-5(c)(2)), the 10-percent shareholder test is applied on the earliest of when the interest is distributed by the partnership to the foreign partner, the date that the statement under section 6031(c) is mailed or otherwise provided to such partner, or the due date for furnishing such statement. See §§1.1441-5(b)(2) and 1.1441-5(c)(2)(iii).

### *4. Application of the 10-percent Shareholder Test to Interest Paid to a Simple or Grantor Trust.*

Under subchapter J of the Code, a trust generally computes its taxable income in the same manner as an individual. See section 641(b). However, subchapter J contains rules that generally permit a trust required to distribute all of its income currently (simple trust) a deduction for the amounts it is required to distribute. See section 651. To the extent a simple trust claims a deduction for amounts it is required to distribute to its beneficiaries, the

trust acts as a passthrough entity because such amounts are generally subject to taxation in the hands of the beneficiaries of the trust under section 652.

Further, subchapter J contains so called grantor trust rules pertaining to trust arrangements where a grantor or other person has retained rights or powers with respect to trust property or trust income. See sections 671-679. Pursuant to the grantor trust rules, the grantor or other person may be considered the owner of all or a portion of the trust. To the extent that the grantor or other person is considered the owner of any portion of a trust, the grantor or other person (and not the trust) is required to take into account those items of income, deduction, and credit attributable to the portion owned when computing the grantor or other owner's taxable income. See section 671.

When interest is paid to a simple trust or a grantor trust, an issue arises as to whether the 10-percent shareholder test should be applied at the trust or beneficiary or owner level. Accordingly, the proposed regulations provide rules for that context. Under the proposed regulations, when interest is paid to a simple trust or grantor trust and such interest is distributed to or included in the gross income of a nonresident alien individual or foreign corporation that is a beneficiary or owner of such trust, as the case may be, the withholding agent is to apply the rules of the proposed regulations with respect to determining whether a 10-percent shareholder has received interest, at the beneficiary or owner level. Further, the 10-percent shareholder test is applied with respect to a nonresident alien individual or foreign corporation that is a beneficiary of a simple trust or an owner of a grantor trust at the time that a withholding agent, absent any exceptions, would otherwise be required to withhold under sections 1441 and 1442 with respect to such interest.

### **Effective Date**

These proposed regulations apply to interest paid on obligations issued on or after the date that the regulations are issued as final regulations.

### **Special Analyses**

It has been determined that this notice of proposed rulemaking is not a significant

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

### **Comments and Public Hearing**

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The Treasury Department and the IRS 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 has been scheduled for September 7, 2006, beginning at 10 a.m., in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the "FOR FURTHER INFORMATION CONTACT" section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by July 13, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the

deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

### Drafting Information

The principal author of the proposed regulations is Jason Kleinman, Office of Associate Chief Counsel (International). 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 continues to read in part as follows:

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

Par. 2. Section 1.871-14 is amended as follows:

1. Paragraphs (g) and (h) are redesignated as paragraphs (h) and (i), respectively.

2. New paragraph (g) is added.

The addition reads as follows:

*§1.871-14 Rules relating to repeal of tax on interest of nonresident alien individuals and foreign corporations received from certain portfolio debt investments.*

\* \* \* \* \*

(g) *Portfolio interest not to include interest received by 10-percent shareholders*—(1) *In general*. For purposes of section 871(h), the term *portfolio interest* shall not include any interest received by a 10-percent shareholder.

(2) *Ten-percent shareholder*—(i) *In general*. The term *10-percent shareholder* means—

(A) In the case of an obligation issued by a corporation, any person who owns 10-percent or more of the total combined voting power of all classes of stock of such corporation entitled to vote; or

(B) In the case of an obligation issued by a partnership, any person who owns 10-percent or more of the capital or profits interest in such partnership.

(ii) *Ownership*—(A) *Stock ownership*. For purposes of paragraph (g)(2)(i)(A) of this section, *stock owned* means stock directly or indirectly owned and stock owned by reason of the attribution rules of section 318(a), as modified by section 871(h)(3)(C).

(B) *Ownership of partnership interest*—(1) For purposes of paragraph (g)(2)(i)(B) of this section, rules similar to the rules in paragraph (g)(2)(ii)(A) of this section shall be applied in determining the ownership of a capital or profits interest in a partnership.

(2) *Special rules*. [Reserved].

(3) *Application of 10-percent shareholder test to partners receiving interest through a partnership*—(i) *Partner level test*. Whether interest paid to a partnership and included in the distributive share of a partner that is a nonresident alien individual or foreign corporation, is received by a 10-percent shareholder, shall be determined by applying the rules of this paragraph (g) only at the partner level.

(ii) *Time at which 10-percent shareholder test is applied*. The determination of whether a nonresident alien individual or foreign corporation that is a partner in a partnership is a 10-percent shareholder under the rules of section 871(h)(3), section 881(c)(3), and this paragraph (g) with respect to interest paid to such partnership shall be made at the time that the withholding agent, absent the provisions of section 871(h), 881(c) and the rules of this paragraph, would otherwise be required to withhold under sections 1441 and 1442 with respect to such interest. For example, in the case of U.S. source interest paid by a domestic corporation to a domestic partnership or withholding foreign partnership (as defined in §1.1441-5(c)(2)), the 10-percent shareholder test is applied on the earliest of when the interest is distributed by the partnership to the foreign partner, the date that the statement under section 6031(c) is mailed or otherwise provided to such partner, or the due date for furnishing such statement. See §1.1441-5(b)(2) and (c)(2)(iii).

(4) *Application of 10-percent shareholder test to interest paid to a simple trust or grantor trust*. Whether interest paid to a simple trust or grantor trust and distributed to or included in the gross income of a nonresident alien individual or

foreign corporation that is a beneficiary or owner of such trust, as the case may be, is received by a 10-percent shareholder, shall be determined by applying the rules of this paragraph (g) only at the beneficiary or owner level. The 10-percent shareholder test is applied with respect to a nonresident alien individual or foreign corporation that is a beneficiary of a simple trust or an owner of a grantor trust at the time that a withholding agent, absent any exceptions, would otherwise be required to withhold under sections 1441 and 1442 with respect to such interest.

(5) *Effective date*. The rules of this paragraph (g) apply to interest paid on obligations issued on or after the date these regulations are issued as final regulations.

Par. 3. Section 1.881-2(a)(6) is added to read as follows:

*§1.881-2 Taxation of foreign corporations not engaged in U.S. business.*

(a) \* \* \*

(6) Interest received by a foreign corporation pursuant to certain portfolio debt instruments is not subject to the flat tax of 30 percent described in paragraph (a)(1) of this section. For rules applicable to a foreign corporation's receipt of interest on certain portfolio debt instruments, see sections 871(h), 881(c), and §1.871-14.

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

(Filed by the Office of the Federal Register on June 12, 2006, 8:45 a.m., and published in the issue of the Federal Register for June 12, 2006, 71 F.R. 34047)

## Guidance Under Section 1502; Amendment of Tacking Rule Requirements of Life-Nonlife Consolidated Regulations; and Guidance Necessary to Facilitate Business Electronic Filing and Burden Reduction; Correction

### Announcement 2006-46

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correcting amendment.

**SUMMARY:** This document contains corrections to temporary regulations (T.D. 9258, 2006–20 I.R.B. 886) that were published in the **Federal Register** on Tuesday April 25, 2006 (71 FR 23856) relating to guidance regarding amendments to tacking rule requirements of Life-Nonlife consolidated regulations under section 1502; and final and temporary regulations (T.D. 9264, 2006–26 I.R.B. 1150), that were published in the **Federal Register** on Tuesday, May 30, 2006 (71 FR 30591) relating to guidance necessary to facilitate business electronic filing and burden reduction.

**DATES:** The amendment to §1.1502–76T that was published April 25, 2006, is effective April 25, 2006. The amendments to §§1.1563–1 and 602.101 and the removal of §1.1502–76T that was published on May 30, 2006, is effective May 30, 2006.

**FOR FURTHER INFORMATION CONTACT:** Grid Glycer, (202) 622–7930 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

### Background

The temporary regulations (T.D. 9258) and final and temporary regulations (T.D. 9264) that are the subject of these corrections are under sections 332, 351, 355, 368, 1081, 1502, and 1563 of the Internal Revenue Code.

### Need for Correction

As published, T.D. 9258 and T.D. 9264 contain errors that may prove to be misleading and are in need of clarification. T.D. 9264 added §1.1502–76T in error, as §1.1502–76T was previously codified by T.D. 9258. This correcting amendment amends §1.1502–76T as codified by T.D. 9258, and removes §1.1502–76T as codified by T.D. 9264.

\* \* \* \* \*

### Correction of Publication

Accordingly, 26 CFR parts 1 and 602 are corrected by making the following correcting amendments:

## PART 1—INCOME TAXES

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

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

**Par. 2.** Section 1.1502–76T published on April 25, 2006, as T.D. 9258 is amended by revising paragraphs (b) through (c)(3) and adding paragraph (d) to read as follows:

*§1.1502–76T Taxable year of members of group (temporary).*

\* \* \* \* \*

(b) through (b)(2)(ii)(C) [Reserved]. For further guidance, see §1.1502–76(b) through (b)(2)(ii)(C).

(D) *Election—(1) Statement.* The election to ratably allocate items under paragraph (b)(2)(ii) of §1.1502–76 must be made in a separate statement entitled, “THIS IS AN ELECTION UNDER §1.1502–76(b)(2)(ii) TO RATABLY ALLOCATE THE YEAR’S ITEMS OF [INSERT NAME AND EMPLOYER IDENTIFICATION NUMBER OF THE MEMBER].” The election must be filed by including a statement on or with the returns including the items for the years ending and beginning with S’s change in status. If two or more members of the same consolidated group, as a consequence of the same plan or arrangement, cease to be members of that group and remain affiliated as members of another consolidated group, an election under this paragraph (b)(2)(ii)(D)(1) may be made only if it is made by each such member. Each statement must also indicate that an agreement, as described in paragraph (b)(2)(ii)(D)(2) of this section, has been entered into. Each party signing the agreement must retain either the original or a copy of the agreement as part of its records. See §1.6001–1(e).

(2) *Agreement.* For each election under §1.1502–76 (b)(2)(ii), the member and the common parent of each affected group must sign and date an agreement. The agreement must—

(i) Identify the extraordinary items, their amounts, and the separate or consolidated returns in which they are included;

(ii) Identify the aggregate amount to be ratably allocated, and the portion of the

amount included in the separate and consolidated returns; and

(iii) Include the name and employer identification number of the common parent (if any) of each group that must take the items into account.

(b)(2)(iii) through (c) [Reserved]. For further guidance, see §1.1502–76(b)(2)(iii) through (c).

(d) *Effective date—(1) Applicability date—(i)* Paragraph (a) of this section applies to any original consolidated Federal income tax return due (without extensions) on or after April 25, 2006.

(ii) Paragraph (b)(2)(ii)(D) of this section applies to any original consolidated Federal income tax return due (without extensions) after May 30, 2006. However, a consolidated group may apply this section to any original consolidated Federal income tax return (including any amended return filed on or before the due date (including extensions) of such original return) timely filed on or after May 30, 2006.

(2) *Expiration date—(i)* The applicability of paragraph (a) of this section will expire on April 25, 2009.

(ii) The applicability of paragraph (b)(2)(ii)(D) of this section will expire on May 26, 2009.

### §1.1502–76T [Removed]

**Par. 3.** Section 1.1502–76T published on May 30, 2006, as T.D. 9264 is removed.

**Par. 4.** Section 1.1563–1 is amended by adding paragraph (c)(2)(iv) and revising paragraph (e) to read as follows:

*§1.1563–1 Definition of controlled group of corporations and component members.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(iv) The provisions of this paragraph (c)(2) may be illustrated by the following examples (in which it is assumed that all the individuals are unrelated):

*Example 1.* On each day of 1970 all the outstanding stock of corporations M, N, and P is held in the following manner:



Individuals	Corporations		
	M	N	P
A .....	55%	40%	5%
B .....	40%	20%	40%
C .....	5%	40%	55%

Since the more-than-50-percent stock ownership requirement of section 1563(a)(2)(B) is met with respect to corporations M and N and with respect to corporations N and P, but not with respect to corporations M, N, and P, corporation N would, without the application of this paragraph (c)(2), be a component mem-

ber on December 31, 1970, of overlapping groups consisting of M and N and of N and P. If N does not file an election in accordance with §1.1563-1T(c)(2)(i), the Internal Revenue Service will determine the group in which N is to be included.

*Example 2.* On each day of 1970, all the outstanding stock of corporations S, T, W, X, and Z is held in the following manner:

Individuals	Corporations				
	S	T	W	X	Z
D .....	52%	52%	52%	52%	52%
E .....	40%	2%	2%	2%	2%
F .....	2%	40%	2%	2%	2%
G .....	2%	2%	40%	2%	2%
H .....	2%	2%	2%	40%	2%
I .....	2%	2%	2%	2%	40%

On December 31, 1970, the more-than-50-percent stock ownership requirement of section 1563(a)(2)(B) may be met with regard to any combination of the corporations but all five corporations cannot be included as component members of a single controlled group because the inclusion of all the corporations in a single group would be dependent upon taking into account the stock ownership of more than five persons. Therefore, if the corporations do not file a statement in accordance with §1.1563-1T(c)(2)(ii), the Internal Revenue Service will determine the group in which each corporation is to be included. The corporations or the Internal Revenue Service, as the case may be, may designate that three corporations be included in one group and two corporations in another, or that any four corporations be included in one group and that the remaining corporation not be included in any group.

(d) \* \* \*

(e) [Reserved]. For further guidance, see §1.1563-1T(e)(1).

**PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT**

**Par. 5.** The authority citation for part 602 continues to read in part as follows:

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

**§602.101 [Amended]**

**Par. 6.** Section 602.101, paragraph (b) is amended by removing the entries for 1.332-6, 1.351-3, 1.355-5, 1.368-3, and 1.1081-11.

Cynthia E. Grigsby,  
*Senior Federal Register Liaison Officer,  
Publications and Regulations Branch,  
Associate Chief Counsel  
(Procedure and Administration).*

(Filed by the Office of the Federal Register on June 8, 2006, 3:47 p.m., and published in the issue of the Federal Register for June 13, 2006, 71 F.R. 34009)

**Guidance Necessary to Facilitate Business Electronic Filing and Burden Reduction; Correction**

**Announcement 2006-47**

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains corrections to a notice of proposed rulemaking by cross-reference to temporary regulations (REG-134317-05, 2006-26 I.R.B. 1184) that was published in the **Federal Register** on Tuesday, May 30, 2006 (71 FR 30640) relating to guidance necessary to facilitate business electronic filing and burden reduction.

FOR FURTHER INFORMATION CONTACT: Grid Glycer, (202) 622-7930 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

**Background**

The notice of proposed rulemaking by cross-reference to temporary regulations (REG-134317-05) that are the subject of these corrections is under sections 1502 and 1563 of the Internal Revenue Code.

**Need for Correction**

As published, the notice of proposed rulemaking by cross-reference to temporary regulations (REG-134317-05) contains errors that may prove to be misleading and is in need of clarification.

**Correction of Publication**

Accordingly, the notice of proposed rulemaking by cross-reference to temporary regulations (REG-134317-05), that was the subject of FR Doc. 06-4872, is corrected as follows:

1. On page 30640, column 3, under the heading “Background and Explanation of Provisions”, the fourth through sixth lines from the bottom of the paragraph, the language “1.1502-76T, 1.1502-95T, 1.1563-1T, 1.1563-3T, and amend part 602 to add §1.6012-2T.” is corrected to

read “1.1502–95T, 1.1563–1T, 1.1563–3T, and revise §1.1502–76T; and amend part 602 to add §1.6012–2T.”

2. On page 30642, column 1, under Par. 22., the language “paragraph (c)(2)” is corrected to read “paragraph (c)(2)(i) through (iii)”.

Cynthia E. Grigsby,  
*Senior Federal Register Liaison Officer,  
Publications and Regulations Branch,  
Associate Chief Counsel  
(Procedure and Administration).*

(Filed by the Office of the Federal Register on June 8, 2006, 3:47 p.m., and published in the issue of the Federal Register for June 13, 2006, 71 F.R. 34046)

# 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.

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<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2006–1 through 2006–26 is in Internal Revenue Bulletin 2006–26, dated June 26, 2006.

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<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2006–1 through 2006–26 is in Internal Revenue Bulletin 2006–26, dated June 26, 2006.



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