HIGHLIGHTS OF THIS ISSUE

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

SPECIAL ANNOUNCEMENT

This document contains the annual report to the public concerning Advance Pricing Agreements (APAs) and the experience of the APA Program during calendar year 2006. This document does not provide guidance regarding the application of the arm’s length standard. Instead, it reports on the structure and activities of the APA Program.

INCOME TAX


T.D. 9312, page 736.
REG–115403–05, page 767.
Temporary and proposed regulations under section 181 of the Code provide rules relating to deductions for the cost of producing film and television productions.

Proposed regulations under section 6159 of the Code govern the acceptance and rejection of installment agreements, the terms of those agreements and when they may be modified or terminated by the Service, and appeal procedures when the Service makes a rejection or termination decision. The principal purpose of this project is to update the regulations to reflect various amendments to section 6159 and related statutes.

Notice 2007–17, page 748.
The IRS and Treasury anticipate the launch of a pilot program to solicit greater input from the public in the initial development of certain types of guidance projects. As a model for the pilot program, the IRS and Treasury solicit input from interested parties on whether it is appropriate to amend existing income tax regulations to permit certain modifications to securitized commercial mortgage loans.

This notice invites public comments on draft IRS forms to implement a new information reporting requirement for charities and certain other entities with respect to certain structured insurance contracts. The notice also solicits comments with respect to a Congressionally mandated study being conducted by Treasury and the IRS.

This procedure provides additional guidance regarding the disclosure of certain penalties under section 6707A(e) of the Code on forms filed with the U.S. Securities and Exchange Commission. Rev. Proc. 2005–51, 2005–2 C.B. 296, provides that a person who files SEC Form 10–K, Annual Report, must disclose in Item 3 (Legal Proceedings) of Form 10–K the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51. This procedure describes how persons who are required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or required to be consolidated with another person for purposes of those reports, but that file these periodic reports on a form other than a Form 10–K, must make the appropriate disclosures on these other reports in order to avoid additional penalties. Rev. Proc. 2005–51 amplified.

ESTATE TAX

Proposed regulations under section 6159 of the Code govern the acceptance and rejection of installment agreements, the terms of those agreements and when they may be modified or terminated by the Service, and appeal procedures when the Service makes a rejection or termination decision. The principal purpose of this project is to update the regulations to reflect various amendments to section 6159 and related statutes.

GIFT TAX

Proposed regulations under section 6159 of the Code govern the acceptance and rejection of installment agreements, the terms of those agreements and when they may be modified or terminated by the Service, and appeal procedures when the Service makes a rejection or termination decision. The principal purpose of this project is to update the regulations to reflect various amendments to section 6159 and related statutes.

EMPLOYMENT TAX

Proposed regulations under section 6159 of the Code govern the acceptance and rejection of installment agreements, the terms of those agreements and when they may be modified or terminated by the Service, and appeal procedures when the Service makes a rejection or termination decision. The principal purpose of this project is to update the regulations to reflect various amendments to section 6159 and related statutes.
This procedure provides additional guidance regarding the disclosure of certain penalties under section 6707A(e) of the Code on forms filed with the U.S. Securities and Exchange Commission. Rev. Proc. 2005–51, 2005–2 C.B. 296, provides that a person who files SEC Form 10–K, Annual Report, must disclose in Item 3 (Legal Proceedings) of Form 10–K the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51. This procedure describes how persons who are required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or required to be consolidated with another person for purposes of those reports, but that file these periodic reports on a form other than a Form 10–K, must make the appropriate disclosures on these other reports in order to avoid additional penalties. Rev. Proc. 2005–51 amplified.
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 II.—Treaties and Tax Legislation. This part is divided into two subparts as follows: Subpart A, Tax Conventions and Other Related Items, and Subpart B, Legislation and Related Committee Reports.

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

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

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

Section 181.—Treatment of Certain Qualified Film and Television Productions

26 CFR 1.181–1T: Deduction for qualified film and television production costs (temporary).

T.D. 9312

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

Section 181 — Deduction for Qualified Film and Television Production Costs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulation.

SUMMARY: This document contains temporary regulations relating to deductions for the cost of producing film and television productions under section 181. These temporary regulations reflect changes to the law made by the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005, and affect taxpayers that produce films and television productions within the United States. The text of these temporary regulations also serves as the text of the proposed regulations (REG–115403–05) set forth in the notice of proposed rulemaking published in this issue of the Bulletin.

DATES: Effective Date: These regulations are effective February 9, 2007.

FOR FURTHER INFORMATION CONTACT: Bernard P. Harvey, (202) 622–3110 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These temporary regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–2059. Responses to these collections of information are required to obtain a tax benefit.

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.

For further information concerning this collection of information, and where to submit comments on the collection of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble of the cross-referencing notice of proposed rulemaking published in this issue of the Bulletin.

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

Background


Explanation of Provisions

For several years, independent filmmakers and television producers have moved production activities from the United States to other countries. Frequently, this has been motivated by credits and other incentives offered by foreign governments to attract the economic benefits gained by hosting these productions. Congress enacted section 181 to make domestic production more attractive to these taxpayers.

Section 181 permits the owner of a qualified film or television production to elect to deduct production costs in the year the costs are paid or incurred in lieu of capitalizing the costs and recovering them through depreciation allowances if the aggregate costs do not exceed $15 million for each qualifying production ($20 million if a significant amount of the production costs are incurred in certain designated areas) (the “production cost limit”). A film or television production is a qualified film or television production if 75 percent of the total compensation of the production is compensation for services performed in the United States by actors, directors, producers, and other relevant production personnel (the “75 percent test”).

Allowance of Deduction

The deduction under section 181 is allowed for the cost of producing qualified film and television productions for which principal photography begins after October 22, 2004, and before January 1, 2009. Production costs incurred before or after this period may be deducted so long as principal photography commences during the period.

Section 181 refers to “the taxpayer” who makes the election and takes the deduction. The temporary regulations provide that only the owner of the film or television production may elect to deduct production costs under section 181. Under the regulations, the owner of the production is deemed to be the person or persons otherwise required to capitalize production costs into the basis of the film or television production under section 263A (or the person or persons that would be required to capitalize production costs if subject to section 263A).

The production costs that must be taken into account (for both the amount of the deduction and for the production cost limit) are the amounts that, absent section 181, are required to be capitalized under section 263A (or the amounts that would be required to be capitalized if the taxpayer...
Section 181 does not require the production to be placed in service in order for the producer to begin deducting production costs, and there is no requirement that the production ever be placed in service or completed. However, the temporary regulations require that, at the time the election is made and in any year that a deduction is claimed, a taxpayer must have a reasonable basis for believing that the production will be set for production (as defined in American Institute of Certified Public Accountants Statement of Position 90–2), will be a qualified film or television production upon completion, and will not exceed the production cost limit. For example, a taxpayer that has developed a shooting script, has a well-documented budget, and has obtained financing on the basis of these facts is in a good position to determine whether it has a reasonable basis to claim the deduction.

The temporary regulations treat the cost of acquiring a production as a production cost. This rule is premised upon the understanding that under section 1245, the seller would recapture upon the sale of the production any section 181 deduction that the seller had claimed. In the case of a sale between related parties, the purchaser must treat the greater of the acquisition cost or the seller’s production cost as the purchaser’s production cost for purposes of the production cost limit, notwithstanding that the purchaser’s deduction under section 181 is based on the purchaser’s actual acquisition cost.

In the film industry, once a prospective producer has determined the estimated budget for a production, it usually must obtain financing from a bank or other lender to cover at least part of the production cost. The producer may incur up-front costs in obtaining such financing. The producer’s pre-sale agreements with distributors may be used as collateral for this financing. Generally, the financier will be repaid directly by these distributors upon delivery of the finished production. In addition, the financier will usually require that the producer obtain a completion guarantee (often referred to as a completion bond) as a condition of the loan. The completion guarantee is a guarantee that, if the production costs exceed the budgeted costs or the loan proceeds are mishandled, the film will still be completed and/or the financier will be made whole. A completion guarantee can be satisfied in a number of ways. For example, the guarantor may loan funds to the producer to finish the production, may finance the production itself (although this is rare), or may reimburse the financier for the amount loaned to the producer (plus interest and other charges). Generally, the producer must pay an up-front amount in order to obtain a completion guarantee.

The temporary regulations provide that the costs of obtaining financing, including premium costs for completion guarantees, are production costs that are subject to the production cost limit and are deductible under section 181. In addition, if the completion guarantor loans additional funds to the producer and the funds are expended by the producer to complete the production, or if the completion guarantor incurs additional production costs on its own behalf, the additional funds are production costs under section 181.

Participations and residuals (P&R) are defined in section 167(g)(7)(B), as costs with respect to an item of property described in section 167(g)(6), the amount of which by contract varies with the amount of income earned in connection with the property. In the context of film and television production, participations are payments to actors, directors, and other talent based on a contractually-defined measure of future income from the production. Residuals are payments made pursuant to collective-bargaining agreements, such as those of the directors’ and actors’ guilds, based upon non-theatrical sales, under terms that differ between video, free television, and pay television sales. Participations are generally paid by the producer but may be assumed by a third-party distributor. On the other hand, residuals are generally paid by a distributor out of its gross receipts from the production. Industry accounting generally treats participation payments made by distributors as a deduction in the producer’s profit rather than a production cost, and generally treats residual payments made by distributors as a distribution cost.

Various comments were received with respect to the treatment of P&R under section 181. Some comments suggested that taxpayers be permitted to elect to deduct participation payments (rather than capitalizing those payments into the basis of the production) under the income forecast method rather than section 181. Other comments suggested that Congress, by specifically excluding P&R costs paid or incurred by the taxpayer from the definition of “qualified compensation” in section 181(d)(3), intended these costs to be excluded from the production cost limit in section 181(a)(2). Comments received also suggested that P&R costs should be excluded for purposes of determining whether the production cost limit is exceeded, but nonetheless should be deductible production costs under section 181.

In addition, various comments expressed concerns about productions being subsequently disqualified if P&R costs are included in determining if the production cost limit is exceeded. For example, a taxpayer forecasts its production costs (including a reasonable amount of P&R costs based upon projected income from the production) and based upon this forecast the taxpayer determines it has a reasonable basis for making an election under section 181. However, if an unexpectedly large amount of P&R is later paid as a result of production earnings being much greater than was initially expected, with the result that the total production cost exceeds the production cost limit, the production would become disqualified from treatment under section 181.

The temporary regulations provide that P&R costs are considered production costs for purposes of the production cost limit. The IRS and Treasury Department recognize that P&R costs are costs that are generally subject to capitalization under section 263A (see §1.263A–1(e)(2) and §1.263A–1(e)(3)). Nonetheless, an explicit reference to P&R costs is provided in the temporary regulations in order to avoid any uncertainty with respect to these costs.

The IRS and Treasury Department believe that the statute requires P&R costs
to be included in the production cost limit. For example, the statute specifically provides that participations and residuals are excluded from the definition of compensation for purposes of determining whether the production was a qualified film or television production, as defined in section 181(d)(1). This explicit exclusion is not found in the production cost limit of section 181(a)(2) or elsewhere in section 181.

In addition, the IRS and Treasury Department are concerned that if P&R costs were excluded from the definition of production costs under section 181, section 181(b) could cause them to be nondeductible under any provision of the Internal Revenue Code. Specifically, section 181(b) states that no depreciation or amortization deduction other than the deduction provided under section 181 is allowed for the basis of a qualified film or television production for which an election has been made. Therefore, if P&R costs were excluded from the definition of production costs under section 181, a taxpayer wishing to expense P&R costs under the holding of Associated Patentees, 4 T.C. 979 (1945), may be barred from doing so under section 181(b), as the holding in that case is explicit that a deduction under Associated Patentees is a depreciation deduction of basis.

Additionally, the IRS and Treasury Department are concerned that a blanket exclusion of participations from the definition of production costs would allow taxpayers to manipulate the total production cost (and avoid the production cost limit) by structuring compensation as participation payments. Commentators argued that this potential abuse could be mitigated with an anti-abuse rule that treats only those participations that are disguised non-contingent or guaranteed payments, where the talent incurs minimal risk of non-payment (for example, participations with a payment priority over distribution cost repayment and/or production financing cost repayment) as production costs subject to the production cost limit, but does not treat other participation costs as production costs.

The IRS and Treasury Department considered excluding from the amount to be taken into consideration as production costs any residuals (payments to actors’ or directors’ guilds based on gross income from exploitation in secondary markets) that are paid by the distributor or other third party, under the theory that these payments are costs of exploiting the finished production. However, the same argument could be advanced for participations contingent on income, notwithstanding that most participations are taken in lieu of compensation for services (normal a production cost). In addition, a payment of residuals by a third party is made on the producer’s behalf, and the producer remains the party with ultimate liability for the payment. Thus, the temporary regulations provide that P&R costs are production costs that are deductible under section 181 and are included in the production cost limit.

Section 181(a)(2)(B) provides a higher production cost limit for a qualified film or television production “the aggregate cost of which is significantly incurred” in a designated area. Designated areas include areas eligible for designation as low-income communities or certain distressed counties and isolated areas. However, neither the statute nor its legislative history provides a definition for “significantly incurred,” nor do they explain how the standard should be applied. However, Congress’ stated intent in enacting section 181 was to encourage economic activity in these designated areas. Accordingly, the temporary regulations provide two different tests for establishing when production costs have been significantly incurred in a designated area. One test is based upon production costs while the other is based upon days of production. Under the first of these tests, the temporary regulations establish a 20 percent threshold for the “significantly incurred” standard (similar to the rules of §1.199–3(g)(3)). This test compares production costs incurred in first-unit principal photography that takes place in a designated area to all production costs incurred for first-unit principal photography. First-unit principal photography typically films the primary actors, whereas second-unit principal photography typically films shots that establish location or context (exteriors of buildings, crowds, cars passing). Production costs of principal photography include, for example, compensation to actors, directors and other production personnel, location costs, camera rental and insurance, and catering. This 20 percent test is based upon production costs incurred in first-unit principal photography and ignores all other production costs such as preproduction, editing, and postproduction costs for purposes of the “significantly incurred” requirement. These other production costs often greatly exceed principal photography costs, and must be incurred where adequate production facilities exist (and it is likely that few such facilities are available in the designated areas). The IRS and Treasury Department believe that if all production costs were taken into consideration in determining whether the 20 percent “significantly incurred” threshold had been met, very few films would qualify for the higher production cost limit, even if a substantial amount of principal photography occurred in a designated area. However, we request comments regarding whether the exclusion of preproduction, editing, and postproduction costs will unfairly impact taxpayers.

Comments were received requesting that consideration be given to developing a “significantly incurred” test based upon the number of days of principal photography. The temporary regulations adopt this suggestion and provide, as an alternative to the 20 percent cost-based test, a “significantly incurred” test based upon the total number of days of principal photography. Under this test, if at least 50 percent of the total days of principal photography take place in a designated area, the production will be deemed to have satisfied the “significantly incurred” requirement of section 181(a)(2)(B). This 50 percent test may provide a simpler computation than the 20 percent cost-based test and avoids issues such as the allocation of salaries to specific days of principal photography.

A taxpayer intending to utilize the $20 million production cost limit under section 181(a)(2)(B) must maintain records adequate to demonstrate that it has a reasonable basis under the “significantly incurred” standard to support reliance on the higher dollar limitation.

**Election**

The Conference report underlying section 181 provides that, until the Secretary publishes specific guidance, taxpayers may make a valid election under section 181 by claiming the deduction on the taxpayer’s return for the year that production costs are first incurred. H.R. Conf.
report and the Conference report arguably would exclude productions that do not fall within these delineated categories, such as reality programming, documentaries, sports programs, news programs, variety shows, game shows, live performances, interview and talk shows, commercials and "infomercials," religious/inspirational programming, educational programming, exercise shows, training videos, and others. Comments were received noting that it appeared from the legislative history that Congress intended for the provision to apply only to a motion picture, miniseries, scripted dramatic television episode, or movie of the week. Notwithstanding the legislative history, section 181(d)(2) itself defines a production as "property described in section 168(f)(3)." Section 168(f)(3) property is "any film or video tape." Accordingly, the temporary regulations adopt the broader statutory definition provided in section 168(f)(3) and specifically define a production under section 181 to include any film or video tape production the production cost of which is subject to capitalization under section 263A.

Once a film or television production is released or broadcast, the taxpayer may face additional costs to prepare the production for foreign distribution, rebroadcast (for example, editing a theatrical film for television), or release to the home video market. Consistent with the approach taken under the income forecast method (see section 167(g)(5)(A)(ii)), these costs are not treated as production costs of the film or television production for purposes of the production cost limit under section 181(a)(2), and no deduction may be taken under section 181 for such costs.

Section 181(d)(1) compares qualified compensation to total compensation in applying the 75 percent test. Although qualified compensation is defined by section 181(d)(3)(A) as compensation for services performed in the United States by actors, directors, producers, and other relevant production personnel, the 75 percent test compares this amount to the "total compensation of the production." In order to be consistent with the definition provided for in section 181(d)(3)(A), the temporary regulations define "total compensation of the production" as the total amount of compensation paid for services performed anywhere by actors, directors, producers, and other relevant production personnel in the production of the film or television production. In addition, the temporary regulations specifically provide that the terms compensation and qualified compensation include compensation paid to persons who are not directly employed by the producer.

The term qualified compensation is defined as compensation for services by various participants performed "in the United States." The definition of "United States" in section 7701(a)(9) includes the 50 states and the District of Columbia. Although the goal of section 181 is to encourage economic activity within the United States as defined in section 7701(a)(9), the use of a standard based upon principal photography requires the use of a slightly broader definition that takes into account that the physical act of principal photography may take place on land, at sea, or in the air. Consequently, the temporary regulations provide that a service is performed in the United States for purposes of the 75 percent test if the principal photography to which the service relates occurs within the fifty states, the District of Columbia, the territorial waters of the continental United States, or the airspace or space above the continental United States and its territorial waters.

There are some services related to a production that may physically take place at a variety of places outside the control and knowledge of the producer (for example, training, rehearsal, and pre- and post-production). However, the producer has direct or indirect control and knowledge of the shooting location of principal photography with which these other services are associated. Therefore, the IRS and Treasury Department believe that as a general rule the 75 percent test should be based upon the locations where principal photography occurs.

In this regard, the temporary regulations provide a special rule for animated productions. Although these productions may have a "principal photography" analogue, the production process is completely different and the majority of the work of the "talent" is performed independent of the actual frame photography. Computer-generated animation is not photographed at all. Hand-drawn animated films involve the creation of a storyboard (sketches of the story action) by

that the deduction does not apply to qualified film or television productions with an aggregate production cost in excess of $15 million ($20 million if a significant amount of the production costs are incurred in designated areas.) Section 181 is silent as to what should happen when a production appears to meet the requirements of section 181 in the year the election is first made, but fails to meet those requirements thereafter (for example, when the production cost exceeds $15 million, or when the production no longer meets the 75 percent test).

The temporary regulations provide a recapture provision that requires the recapture of any production costs previously deducted under section 181 in the year the election is voluntarily revoked or the production fails to meet the requirements of section 181. For property already placed in service, the taxpayer must include in income the difference between the aggregate amount claimed under section 181 and the depreciation that would have been otherwise allowable with respect to the production in the same years. For a production not yet placed in service, the taxpayer must include in income the aggregate amount claimed under section 181. The structure of the recapture provision is intended in part to alleviate concerns that including P&R in the definition of production costs under section 181 would cause taxpayers to completely forgo the benefits of section 181. Under the temporary regulations, a taxpayer with a reasonable belief that it is producing a qualified film or television production, and that the production cost will not exceed the production cost limit, will be permitted to elect to currently deduct production costs under section 181 with the understanding that a recapture may be required in a later year if circumstances or expectations change. A taxpayer that is required to recapture previously deducted production costs under section 181 will nonetheless be permitted to deduct otherwise allowable depreciation expenses in future years.

Prior to the technical correction enacted in the Gulf Opportunity Zone Act of 2005, a taxpayer could potentially incur production costs, deduct the production costs under section 181 against ordinary income, then sell the film after holding it for one year and report the proceeds (including the gain attributable to the basis reduction from the section 181 deduction) as a long-term capital gain, effectively converting ordinary income to capital gain. This potential “tax flip,” existed because, as originally enacted, the statute did not specify that the deduction under section 181 is a deduction for depreciation or amortization, or state that it is subject to recapture under section 1245. The technical correction specifically treats a deduction under section 181 as a deduction for depreciation or amortization that is subject to recapture under section 1245, and the temporary regulations follow this rule.

**Effective Date**

The temporary regulations apply to qualified film and television productions with respect to which principal photography or, in the case of an animated production, in-between animation, commenced on or after February 9, 2007 and before January 1, 2009.

**Effect on Other Documents**

The following publications are modified as of February 9, 2007:


**Special Analyses**

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analyses section of the preamble to the cross-reference notice of proposed rulemaking published in this issue of the Bulletin. Pursuant to section 7805(f) of the Code, these regulations have been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.
Drafting Information

The principal author of these regulations is Bernard P. Harvey, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Amendments to the Regulations

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

PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read, in part, as follows: Authority: 26 U.S.C. 7805 * * *

Par. 2. Sections 1.181–0T through 1.181–6T are added to read as follows:

§1.181–0T Table of contents (temporary).

This section lists the table of contents for §§1.181–1T through 1.181–6T.

§1.181–1T Deduction for qualified film and television production costs (temporary).

(a) Deduction.
(1) In general.
(2) Owner.
(3) Production costs.
(b) Limit on amount of production costs and amount of deduction.
(1) In general.
(2) Higher limit for productions in certain areas.
(i) In general.
(ii) Significantly incurred.
(iii) Animated film and television productions.
(iv) Productions incorporating both live action and animation.
(v) Records required.
(c) No other depreciation or amortization deduction allowed.

§1.181–2T Election (temporary).

(a) Time and manner of making election.
(b) Election by entity.
(c) Information required.
(1) Initial election.
(2) Subsequent taxable years.
(3) Deductions by more than one owner.
(d) Revocation of election.
(1) In general.
(2) Consent granted.
(e) Transition rules.
(1) Costs first paid or incurred prior to October 23, 2004.
(2) Returns filed after June 14, 2006, and before March 12, 2007.
(3) Information required.

§1.181–3T Qualified film or television production (temporary).

(a) In general.
(b) Production.
(1) In general.
(2) Special rules for television productions.
(3) Exception for certain sexually explicit productions.
(c) Compensation.
(d) Qualified compensation.
(e) Special rule for acquired productions.
(f) Other definitions.
(1) Actors.
(2) Production personnel.
(3) United States.

§1.181–4T Special rules (temporary).

(a) Recapture.
(1) Applicability.
(2) Principal photography not commencing prior to January 1, 2009.
(3) Amount of recapture.
(b) Recapture under section 1245.

§1.181–5T Examples (temporary).

§1.181–6T Effective date (temporary).

(a) In general.
(b) Application of regulation project REG–115403–05 to pre-effective date productions.
(c) Special rules for returns filed for prior taxable years.

§1.181–7T Deduction for qualified film and television production costs (temporary).

(a) Deduction—(1) In general. The owner (as defined in paragraph (a)(2) of this section) of any film or television production (as defined in §1.181–3T(b)) that the owner reasonably expects will be, upon completion, a qualified film or television production (as defined in §1.181–3T(a)) for which the production costs (as defined in paragraph (a)(3) of this section) will not be in excess of the production cost limit of paragraph (b) of this section may elect to treat all production costs incurred by the owner as an expense that is deductible in the taxable year in which the costs are paid (in the case of a taxpayer who uses the cash method of accounting) or incurred (in the case of a taxpayer who uses the accrual method of accounting). This deduction is subject to recapture if the owner’s expectations prove to be inaccurate. This section provides rules for determining who is the owner of a production, what is a production cost, and the maximum production cost that may be incurred for a production for which an election is made under section 181 of the Internal Revenue Code (Code). Section 1.181–2T provides rules for making the election under section 181. Section 1.181–3T provides definitions and rules concerning qualified film and television productions. Section 1.181–4T provides special rules, including rules for recapture of the deduction. Section 1.181–5T provides examples of the application of §§1.181–1T through 1.181–4T, while §1.181–6T provides the effective date of §§1.181–1T through 1.181–5T.

(2) Owner. For purposes of this section and §§1.181–2T through 1.181–6T, the owner of a production is any taxpayer that is required under section 263A to capitalize costs paid or incurred in producing the production into the cost basis of the production, or that would be required to do so if section 263A applied to that taxpayer. A taxpayer that obtains only a limited license or right to exploit a production, or receives an interest or profit participation in a production as compensation for services, generally is not an owner of the production for purposes of this section and §§1.181–2T through 1.181–6T.

(3) Production costs. (i) The term production costs means all costs paid or incurred by the owner in producing or acquiring a production that are required, absent the provisions of section 181, to be capitalized under section 263A, or that would be required to be capitalized if section 263A applied to the owner. These production costs specifically include, but are not limited to, participations and residuals, compensation paid for services, compensation paid for property rights, non-compensation costs, and costs paid

or incurred in connection with obtaining financing for the production (for example, premiums paid or incurred to obtain a completion bond for the production).

(ii) Production costs do not include costs paid or incurred to distribute or exploit a production (including advertising and print costs).

(iii) Production costs do not include the costs to prepare a new release or new broadcast of an existing film or video after the initial release or initial broadcast of the film or video (for instance, the preparation of a DVD release of a theatrically-released film, or the preparation of an edited version of a theatrically-released film for television broadcast). Costs paid or incurred to prepare a new release or a new broadcast of a film or video that has previously been released or broadcast, therefore, are not taken into account for purposes of paragraph (b) of this section, and may not be deducted under this paragraph (a).

(iv) If a production (or any right or interest in a production) is acquired from any person bearing a relationship to the taxpayer described in section 267(b) or section 707(b)(1), and the costs paid or incurred to acquire the production are less than the seller’s production cost, the purchaser must treat the seller’s production cost as a production cost of the acquired production for purposes of determining whether the aggregate production cost paid or incurred with respect to the production exceeds the applicable production cost limit imposed under paragraphs (b)(1) and (b)(2) of this section. Notwithstanding this paragraph (a)(3)(iv), the taxpayer’s deduction under section 181 is limited to the taxpayer’s acquisition cost of the production plus any further production costs incurred by the taxpayer.

(v) The provisions of this paragraph (a) apply notwithstanding the provisions of section 167(g)(7)(D).

(b) Limit on amount of production cost and amount of deduction—(1) In general.

Except as provided under paragraph (b)(2) of this section, the deduction permitted under section 181 does not apply in the case of any production, the production cost of which exceeds $15,000,000.

(2) Higher limit for productions in certain areas—(i) In general. This section is applied by substituting $20,000,000 for $15,000,000 in the case of any production the aggregate production cost of which is significantly incurred in an area eligible for designation as—

(A) A low income community under section 45D; or

(B) A distressed county or isolated area of distress by the Delta Regional Authority established under 7 U.S.C section 2009aa–1.

(ii) Significantly incurred. The aggregate production cost of a production is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the total production cost incurred in connection with first-unit principal photography for the production is incurred in connection with first-unit principal photography that takes place in such areas; or

(B) At least 50 percent of the total number of days of first-unit principal photography for the production consists of days during which first-unit principal photography takes place in such areas.

(iii) Animated film and television productions. For purposes of an animated film or television production, the aggregate production cost of the production is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the total production cost incurred in connection with keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production is incurred in connection with such activities that take place in such areas; or

(B) At least 50 percent of the total number of days of keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production consists of days during which such activities take place in such areas.

(iv) Productions incorporating both live action and animation. For purposes of a production incorporating both live action and animation, the aggregate production cost of the production is significantly incurred within one or more areas specified in paragraph (b)(2)(i) of this section if—

(A) At least 20 percent of the total production cost incurred in connection with first-unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production is incurred in connection with such activities that take place in such areas; or

(B) At least 50 percent of the total number of days of first unit principal photography, keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production consists of days during which such activities take place in such areas.

(v) Records required. A taxpayer intending to utilize the higher production cost limit under paragraph (b)(2)(i) of this section must maintain records adequate to demonstrate qualification under this paragraph (b)(2).

(c) No other depreciation or amortization deduction allowed. (1) Except as provided in paragraph (c)(2) of this section, an owner that elects to deduct production costs under section 181 with respect to a production may not deduct production costs for that production under any provision of the Code other than section 181 unless §1.181–4T(a) applies to the production. In addition, except as provided in paragraph (c)(2) of this section, an owner that has, in a previous taxable year, deducted any production cost of a production under a provision of the Code other than section 181 is ineligible to make an election with respect to that production under section 181.

(2) An owner may make an election under section 181 despite prior deductions claimed for amortization of the cost of acquiring or developing screenplays, scripts, story outlines, motion picture production rights to books and plays, and other similar properties for purposes of potential future development or production of a production under any provision of the Code if such costs were incurred before the first taxable year in which an election could be made under §1.181–2T(a). However, the production cost of the production does not include costs that a taxpayer has begun to amortize prior to the time that the production is set for production (for further guidance, see Rev. Proc. 2004–36, 2004–1 C.B. 1063, and §601.601(d)(2)(ii)(b) of this chapter).
§1.181–2T Election (temporary).

(a) Time and manner of making election. (1) Except as provided in paragraph (e) of this section, a taxpayer electing to deduct the production cost of a production under section 181 must do so in the time and manner described in this paragraph (a). Except as provided in paragraphs (a)(2) and (e) of this section, the election must be made by the due date (including extensions) for filing the taxpayer’s Federal income tax return for the first taxable year in which production costs (as defined in §1.181–1T(a)(3)) have been paid or incurred. See §301.9100–2 of this chapter for a six-month extension of this period in certain circumstances. The election under section 181 is made separately for each production produced by the owner.

(2) An owner may not make an election under paragraph (a)(1) of this section until the first taxable year in which the owner reasonably expects (based on all of the facts and circumstances) that—

(i) The production will be set for production and will, upon completion, be a qualified film or television production; and

(ii) The aggregate production cost paid or incurred with respect to the production will, at no time, exceed the applicable production cost limit set forth under §1.181–1T(b) of the regulations.

(3) If the election under this paragraph (a) is made in a taxable year subsequent to the taxable year in which production costs were first paid or incurred because paragraph (a)(2) of this section was not satisfied until such subsequent taxable year, the election must be made in the first such taxable year, and any production costs incurred prior to the taxable year in which the taxpayer makes the election are treated as production costs (except as provided in §1.181–1T(c)(2)) that are deductible under §1.181–1T(a) in the taxable year paragraph (a)(2) of this section is first satisfied and the election is made.

(b) Election by entity. In the case of a production owned by an entity, the election is made by the entity. For example, the election is made for each member of a consolidated group by the common parent of the group, for each partner by the partnership, or for each shareholder by the S corporation. The election must be made by the due date (including extensions) for filing the return for the later of the taxable year of the entity in which production costs are first paid or incurred or the first taxable year in which §1.181–2T(a)(2) is satisfied.

(c) Information required—(1) Initial election. For each production to which the election applies, the taxpayer must attach a statement to the return stating that the taxpayer is making an election under section 181 and providing—

(i) The name (or other unique identifying designation) of the production;

(ii) The date production costs were first paid or incurred with respect to the production;

(iii) The amount of production costs (as defined in §1.181–1T(a)(3)) paid or incurred with respect to the production during the taxable year (including costs described in §1.181–2T(a)(3));

(iv) The aggregate amount of qualified compensation (as defined in §1.181–3T(d)) paid or incurred with respect to the production during the taxable year (including costs described in §1.181–2T(a)(3));

(v) The aggregate amount of compensation (as defined in §1.181–3T(c)) paid or incurred with respect to the production during the taxable year (including costs described in §1.181–2T(a)(3));

(vi) If the owner expects that the total production cost of the production will be significantly paid or incurred in (or, if applicable, if a significant portion of the total number of days of principal photography will occur in) one or more of the areas specified in §1.181–1T(b)(2)(i), the identity of the area or areas, the amount of production costs paid or incurred (or the number of days of principal photography engaged in) for the applicable activities described in §1.181–1T(b)(2)(i), (ii), (iii), or (iv), as applicable, that place within such areas, and the total production cost paid or incurred (or the number of days of principal photography engaged in) for such activities (whether or not they take place in such areas), for the taxable year; and

(vii) A declaration that the owner reasonably expects (based on all of the facts and circumstances at the time the election was filed) both that the production will be set for production (or has been set for production) and will be a qualified film or television production, and that the aggregate production cost of the production paid or incurred will not, at any time, exceed the applicable dollar amount set forth under §1.181–1T(b).

(2) Subsequent taxable years. If the owner pays or incurs additional production costs in any taxable year subsequent to the taxable year in which production costs are first deducted under section 181, the owner must attach a statement to its Federal income tax return for that subsequent taxable year providing—

(i) The name (or other unique identifying designation) of the production;

(ii) The date the production costs were first paid or incurred;

(iii) The amount of production costs paid or incurred by the owner with respect to the production during the taxable year;

(iv) The amount of qualified compensation paid or incurred with respect to the production during the taxable year;

(v) The aggregate amount of compensation paid or incurred with respect to the production during the taxable year, and the aggregate amount of compensation paid or incurred with respect to the production in all prior taxable years;

(vi) If the owner expects that the total production cost of the production will be significantly paid or incurred in (or, if applicable, if a significant portion of the total number of days of principal photography will occur in) one or more of the areas specified in §1.181–1T(b)(2)(i), the identity of the area or areas, the amount of production costs paid or incurred (or the number of days of principal photography engaged in) for the applicable activities described in §1.181–1T(b)(2)(i), (ii), (iii), or (iv), as applicable, that take place within such areas, and the total production cost paid or incurred (or the number of days of principal photography engaged in) for such activities (whether or not they take place in such areas), for the taxable year; and
(3) Deductions by more than one owner. If more than one taxpayer will claim deductions under section 181 with respect to the production for the taxable year, each owner (but not the members of an entity who are issued a Schedule K–1 by the entity with respect to their interest in the production) must provide a list of the names and taxpayer identification numbers of all such taxpayers, the dollar amount that each such taxpayer is entitled to deduct under section 181, and the information required by paragraphs (c)(1)(iii) through (vi) and (e)(2)(iii) through (vi) of this section for all owners.

(d) Revocation of election—(1) In general. An election made under this section may not be revoked without the consent of the Secretary.

(2) Consent granted. The Secretary’s consent to revoke an election under this section with respect to a particular production will be granted if the owner—

(i) Files a Federal income tax return in which the owner complies with the recapture provisions of §1.181–4T(a) to recapture the amount described in §1.181–4T(a)(3); and

(ii) Attaches a statement to the owner’s return clearly indicating the name (or other unique identifying designation) of the production, and stating that the election under section 181 with respect to that production is being revoked pursuant to §1.181–2T(d)(2).

(e) Transition rules—(1) Costs first paid or incurred prior to October 23, 2004. If a taxpayer begins principal photography of a production after October 22, 2004, but first paid or incurred production costs before October 23, 2004, the taxpayer is entitled to make an election under this section with respect to those costs. If, before June 15, 2006, the taxpayer filed its Federal tax return for the taxable year in which production costs were first paid or incurred, and if the taxpayer wants to make a section 181 election for that taxable year, the taxpayer may make the election either by—

(i) Filing an amended Federal tax return for the taxable year in which production costs were first paid or incurred, and for all subsequent affected taxable year(s), on or before November 15, 2006, provided that all of these years are open under the period of limitations for assessment under section 6501(a); or

(ii) Filing a Form 3115, “Application for Change in Accounting Method,” for the first or second taxable year ending on or after December 31, 2005, in accordance with the administrative procedures issued under §1.1446–1(e)(3)(ii) for obtaining the Commissioner’s automatic consent to a change in accounting method (for further guidance, for example, see Rev. Proc. 2002–9, 2002–1 C.B. 327, and §601.601(d)(2)(ii)(b) of this chapter). This change in method of accounting results in a section 481 adjustment. Further, any limitations on obtaining the automatic consent of the Commissioner do not apply to a taxpayer seeking to change its method of accounting under this paragraph (e)(1). Moreover, the taxpayer must include on line 1a of the Form 3115 the designated automatic accounting method change number “100”.

(2) Returns filed after June 14, 2006, and before March 12, 2007. If, after June 14, 2006, and before March 12, 2007, the owner of a film or television production filed its original Federal income tax return for a taxable year ending after October 22, 2004, without making an election under section 181 for production costs first paid or incurred after October 22, 2004, and if the taxpayer wants to make an election under section 181 for production costs first paid or incurred during that taxable year, the taxpayer must make the election within the time provided by paragraph (a) of this section and in the manner provided in paragraph (c)(1) of this section, except that the election statement attached to the return must include the information required in paragraphs (c)(1)(i) through (vi) of this section.

(3) Information required. If, in accordance with paragraph (e)(1) of this section, the taxpayer is making an election for a prior taxable year by filing amended Federal tax return(s), the statement and information required by paragraphs (c)(1) and (c)(2) of this section must be attached to each amended return. If, in accordance with paragraph (e)(1) of this section, the taxpayer is making a section 181 election for a prior taxable year by filing a Form 3115 for the first or second taxable year ending on or after December 31, 2005, the statement and information required by paragraphs (c)(1) and (c)(2) of this section must be attached to the Form 3115. For purposes of the preceding sentence, the amount of the cost or compensation paid or incurred for the production must only include the amount paid or incurred in taxable years prior to the year of change (for further guidance on year of change, see section 5.02 of Rev. Proc. 2002–9 and §601.601(d)(2)(ii)(b) of this chapter).

§1.181–3T Qualified film or television production (temporary).

(a) In general. The term qualified film or television production means any production (as defined in paragraph (b) of this section) if not less than 75 percent of the total amount of compensation (as defined in paragraph (c) of this section) paid with respect to the production is qualified compensation (as defined in paragraph (d) of this section).

(b) Production—(1) In general. Except as provided in paragraph (b)(3) of this section, for purposes of this section and §§1.181–1T, 1.181–2T, 1.181–4T, 1.181–5T, and 1.181–6T, a film or television production (or production) means any film or video (including digital video) production the production cost of which is subject to capitalization under section 263A, or that would be would be subject to capitalization if section 263A applied to the owner of the production.

(2) Special rules for television productions. Each episode of a television series is a separate production to which the rules, limitations, and election requirements of this section and §§1.181–1T, 1.181–2T, 1.181–4T, 1.181–5T, and 1.181–6T apply. A taxpayer may elect to deduct production costs under section 181 only for the first 44 episodes of a television series (including pilot episodes). A television series may include more than one season of programming.

(3) Exception for certain sexually explicit productions. A production does not include property with respect to which records are required to be maintained under 18 U.S.C. 2257. Section 2257 of Title 18 requires maintenance of certain records with respect to any book, magazine, periodical, film, videotape, or other matter that—

(i) Contains one or more visual depictions made after November 1, 1990, of active sexually explicit conduct; and

(ii) is produced in whole or in part with materials that have been mailed or shipped.
in interstate or foreign commerce, or is shipped or transported or is intended for shipment or transportation in interstate or foreign commerce.

(c) Compensation. The term compensation means, for purposes of this section and §1.181–2T(c), all payments made by the owner (whether paid directly by the owner or paid indirectly on the owner’s behalf) for services performed by actors (as defined in paragraph (f)(1) of this section), directors, producers, and other relevant production personnel (as defined in paragraph (f)(2) of this section) with respect to the production. Indirect payments on the owner’s behalf include, for example, payments by a partner on behalf of an owner that is a partnership, payments by a shareholder on behalf of an owner that is a corporation, and payments by a contract producer on behalf of an owner. Payments for services include all elements of compensation as provided for in §1.263A–1(e)(2)(i)(B) and (3)(ii)(D).

Compensation is not limited to wages or salaries in §1.263A–1(e)(2)(i)(B) and (3)(ii)(D).

(d) Qualified compensation. The term qualified compensation means, for purposes of this section and §1.181–2T(c), all payments made by the owner (whether paid directly by the owner or paid indirectly on the owner’s behalf) paid for services performed in the United States (as defined in paragraph (f)(3) of this section) by actors, directors, producers, and other relevant production personnel with respect to the production. A service is performed in the United States for purposes of this paragraph (d) if the principal photography to which the compensated service relates occurs within the United States and the person performing the service is physically present in the United States. For purposes of an animated film or animated television production, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances are performed is considered in lieu of the location of principal photography. For purposes of a production incorporating both live action and animation, the location where production activities such as keyframe animation, in-between animation, animation photography, and the recording of voice acting performances for the production is considered in addition to the location of principal photography.

(e) Special rule for acquired productions. A taxpayer who acquires an unfinished production from a prior owner must take into account all compensation paid by or on behalf of the seller and any previous owners in determining if the production is a qualified film or television production as defined in paragraph (a) of this section. Any owner seeking to deduct as a production cost either the cost of acquiring a production or any subsequent production costs should obtain from the seller detailed records concerning the compensation paid with respect to the production in order to demonstrate the eligibility of the production under section 181.

(f) Other definitions. The following definitions apply for purposes of this section and §§1.181–1T, 1.181–2T, 1.181–4T, 1.181–5T, and 1.181–6T:

(1) Actors. The term actors includes players, newscasters, or any other persons who are compensated for their performance or appearance in a production.

(2) Production personnel. The term production personnel includes, for example, writers, choreographers, and composers providing services during production, casting agents, camera operators, set designers, lighting technicians, make-up artists, and others who are compensated for providing services directly related to producing the production.

(3) United States. The term United States includes the 50 states, the District of Columbia, the territorial waters of the continental United States, the airspace or space over the continental United States and its territorial waters, and the seabed and subsoil of those submarine areas that are adjacent to the territorial waters of the continental United States and over which the United States has exclusive rights, in accordance with international law, with respect to the exploration and exploitation of natural resources. The term United States does not include possessions and territories of the United States (or the airspace or space over these areas).

§1.181–4T Special rules (temporary).

(a) Recapture—(1) Applicability. The rules of this paragraph (a) apply notwithstanding whether a taxpayer has satisfied the requirements of §1.181–2T(d). A taxpayer that, with respect to a production, claimed a deduction under section 181 in any taxable year in an amount in excess of the amount that would be allowable as a deduction for that year in the absence of section 181 must recapture deductions as provided for in paragraph (a)(3) of this section for the production in the first taxable year in which—

(i) The aggregate production cost of the production exceeds the applicable production cost limit under §1.181–1T(b);

(ii) The owner no longer reasonably expects (based on all of the facts and circumstances at the time the election was filed) both that the production will be set for production (or has been set for production) and will be a qualified film or television production, and that the aggregate production cost of the production paid or incurred will not, at any time, exceed the applicable dollar amount set forth under §1.181–1T(b); or

(iii) The taxpayer revokes the election pursuant to §1.181–2T(d).

(2) Principal photography not commencing prior to January 1, 2009. If a taxpayer claims a deduction under section 181 with respect to a production for which principal photography does not commence prior to January 1, 2009, the taxpayer must recapture deductions as provided for in paragraph (a)(3) of this section in the taxpayer’s taxable year that includes December 31, 2008.

(3) Amount of recapture. A taxpayer subject to recapture under this §1.181–4T must, in the taxable year in which recapture is triggered, include in the taxpayer’s gross income and add to the taxpayer’s adjusted basis in the property—

(i) For a production that is placed in service in a taxable year prior to the taxable year in which recapture is triggered, the difference between the aggregate amount claimed as a deduction under section 181 with respect to the production in all such prior taxable years and the aggregate depreciation deductions that would have been allowable with respect to the property for such prior taxable years (or that the taxpayer could have elected to deduct

in the taxable year that the property was placed in service) with respect to the production under the taxpayer’s method of accounting; or

(ii) For a production that has not been placed in service, the aggregate amount claimed as a deduction under section 181 with respect to the production in all such prior taxable years.

(b) Recapture under section 1245. For purposes of recapture under section 1245, any deduction allowed under section 181 is treated as a deduction allowable for amortization.

§1.181–5T Examples (temporary).

The following examples illustrate the application of §§1.181–1T through 1.181–4T:

Example 1. X, a corporation using a calendar taxable year, is a producer of films. X is the owner (within the meaning of §1.181–1T(a)(2)) of film ABC. X incurs production costs in year 1, but does not commence principal photography for film ABC until year 2. In year 1, X reasonably expects, based on all of the facts and circumstances, that film ABC will be a qualified film or television production, and that at no time will the production cost of film ABC exceed the applicable production cost limit of §1.181–1T(b). Provided that X satisfies all other requirements of §§1.181–1T through 1.181–5T, X may deduct the expected production cost of film ABC above $15 million in year 4. X includes in income in year 3 the deductions claimed in year 1 and in year 2 as provided for in §1.181–4T. X has successfully revoked its election pursuant to §1.181–2T(d).

Example 2. In year 3, X completes production of film ABC at a cost of $14.5 million and places it into service. ABC is an unexpected success in year 4, causing participation payments to drive the total production cost of film ABC above $15 million in year 4. X includes in income in year 4 as recapture under §1.181–4T(a) the difference between the deductions claimed in year 1, year 2, and year 3, and the deductions that it would have claimed under the income forecast method described in section 167(g) of the Internal Revenue Code, a method that was allowable for the film in year 3 (the year the film was placed in service). Because X calculated the recapture amount by comparing actual deductions to deductions under the income forecast method, X must use this method to calculate deductions for film ABC for year 4 and in subsequent taxable years.

§1.181–6T Effective date (temporary).

(a) In general. (1) Section 181 applies to productions commencing after October 22, 2004, and shall not apply to productions commencing after December 31, 2008. Except as provided in paragraphs (b) and (c) of this section, §§1.181–1T through 1.181–5T apply to productions, the first day of principal photography for which occurs after October 22, 2004, and before February 9, 2007, provided that the taxpayer applies all provisions in §§1.181–1T through 1.181–5T to the productions.

(c) Special rules for returns filed for prior taxable years. If before March 12, 2007, an owner of a film or television production began principal photography (or “in-between” animation) for the production after October 22, 2004, and filed its original Federal income tax return for the year such costs were first paid or incurred without making an election under section 181 for the costs of the production, and if the taxpayer wants to make an election under section 181 for such taxable year, see §1.181–2T(e) for the time and manner of making the election.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:


Par. 4. In §602.101, paragraph (b) is amended by adding the following entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(b) * * *

Section 7805.—Rules and Regulations

26 CFR 301.7805–1: Rules and regulations.


Rev. Rul. 2007–14

The Internal Revenue Service is continuing its program of reviewing guidance (including revenue rulings, revenue procedures, notices, and actions relating to decisions of the Tax Court) published in the Internal Revenue Bulletin to identify items that are obsolete because (1) the applicable statutory provisions have been changed or repealed; (2) the matter is specifically covered by statute, regulations, or subsequent published position; or (3) the facts on which the position is based no longer occur or are not sufficiently described to permit clear application of the current statute and regulations.

The following revenue ruling is partially obsolete. Rev. Rul. 54–19, 1954–1 C.B. 179, is obsolete with respect to the income tax conclusion, but not with respect to the estate tax conclusion.

In addition, the rulings listed below are obsolete.

<table>
<thead>
<tr>
<th>Ruling No.</th>
<th>C.B. Citation</th>
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<tbody>
<tr>
<td>Rev. Rul. 57–505</td>
<td>1957–2 C.B. 50</td>
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<tr>
<td>Rev. Rul. 69–212</td>
<td>1969–1 C.B. 34</td>
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Furthermore, in light of the amendments to § 104(a)(2) of the Internal Revenue Code under § 1605 of the Small Business Job Protection Act of 1996, Pub. L. No. 104–188, 110 Stat. 1838 (1996), certain acquiescences to decisions are obsolete. These amendments make clear that Congress intended “that the exclusion from gross income [under § 104(a)(2)] only applies to damages received on account of a personal physical injury or physical sickness”, and thus damages received on account of personal nonphysical injuries or nonphysical sickness generally would be required to be included in gross income. H.R. Conf. Rep. No. 737, 104th Cong., 2d Sess. 301 (1996), 1996–3 C.B. 1041. Consequently, acquiescences to the following decisions are withdrawn:


DRAFTING INFORMATION

The principal author of this revenue ruling is Christina M. Glendening of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Ms. Glendening at (202) 622–4920 (not a toll-free call).
Part III. Administrative, Procedural, and Miscellaneous

Modifications of Commercial Mortgage Loans Held by a REMIC

Notice 2007–17

I. PURPOSE

The Internal Revenue Service (IRS) and the Department of the Treasury (Treasury) receive many requests from the public to resolve issues through published guidance. Available resources limit the number of issues that can be addressed. As a result, publication of guidance on many important tax issues is often delayed. Illustrative of the requests for guidance received by the IRS and Treasury is a recent request for an expansion of the permitted types of modifications to loan obligations held by a real estate mortgage investment conduit (“REMIC”). This request relates to guidance in a narrow, technical area of the tax law, where the need for guidance is driven by market changes with which taxpayers may be more familiar than are the IRS and Treasury.

The IRS and Treasury have made, and continue to make, efforts to develop ways of publishing guidance in a more timely and efficient manner. As part of this effort, the IRS and Treasury anticipate the launch of a pilot program to solicit greater input from the public in the initial development of certain guidance projects.

Under this pilot program, the IRS and Treasury would publish a notice for each guidance project selected for the program. The notice would identify research, background documents, drafts of proposed guidance and other work products, and ask interested parties to provide them. These written submissions from the public will help the IRS and Treasury determine whether it is appropriate to publish guidance. If so, the IRS and Treasury expect that increased public participation in the preliminary stages of certain guidance development would provide a significant benefit to taxpayers by permitting IRS and Treasury to hasten the publication of a greater number of guidance projects. It is anticipated that notices issued under the pilot program would follow the model of this notice, relating to modifications of commercial loan obligations held by a REMIC.

As this and additional projects are completed, the IRS and Treasury will review and evaluate the pilot program. Comments on the program may be solicited, and IRS and Treasury will consider publishing guidelines for future projects.

As a model for the pilot program, the IRS and Treasury solicit input, in the specific format described below, on whether it is appropriate to amend existing income tax regulations to permit certain modifications to securitized commercial mortgage loans.

II. BACKGROUND

The REMIC provisions contained in Part IV of subchapter M of Chapter 1 of the Internal Revenue Code (sections 860A - 860G) provide for a pass-through vehicle that issues multiple classes of interests in pools of residential and commercial mortgage loans. All of the income from the mortgage loans in the REMIC is taxed to the holders of the regular and residual interests in the REMIC. Among the requirements for qualification are that the mortgage loans held by the REMIC must consist of “qualified mortgages” that are principally secured by an interest in real property. All of a REMIC’s loans must be incurred on the startup day of the REMIC or within three months thereafter, except that the REMIC may exchange a defective loan for a “qualified replacement mortgage” for up to two years.

Section 1.860G–2(b)(3) of the Income Tax Regulations provides that, subject to certain exceptions described in section 1.860G–2(b)(3), if an obligation is significantly modified, then the modified obligation is treated as one that was newly issued in exchange for the unmodified obligation that it replaced. If such a significant modification occurs after the obligation has been contributed to the REMIC and the modified obligation is not a qualified replacement mortgage, the modified obligation will not be a qualified mortgage and the deemed disposition of the unmodified obligation will be a prohibited transaction under section 860F(a)(2). Section 1.860G–2(b)(2) defines a “significant modification” as any change in the terms of an obligation that would be treated as an exchange of obligations under section 1001 and the related regulations. The treatment of specific loan modifications as deemed exchanges is addressed in section 1.1001–3. Section 1.1001–3 defines a loan modification and provides that a modification that is significant will be treated as a deemed exchange of the original loan for a new loan.

Section 1.860G–2(b)(3) sets forth four types of loan modifications that are expressly permitted without regard to the section 1001 modification rules. The four permitted modifications are: (i) changes in the terms of the obligation occasioned by default or a reasonably foreseeable default; (ii) assumption of the obligation; (iii) waiver of a due-on-sale clause or a due on encumbrance clause; and (iv) conversion of an interest rate by a mortgagor pursuant to the terms of a convertible mortgage.

The present REMIC regulations were adopted in 1992 at a time when the mortgage-backed securities market involved primarily residential mortgage loans. Since the adoption of the REMIC regulations, the securitization of commercial real estate mortgages has become more common. The four types of modifications that are expressly permitted without regard to the section 1001 modification rules cover the most common changes affecting residential mortgage loans, but may not cover the range of likely changes in commercial mortgage loans.

To accommodate commercial mortgage loans, the IRS and Treasury are considering whether the present REMIC regulations should be amended to reflect the evolution of market practices in the mortgage-backed securities industry. In particular, the IRS and Treasury are considering whether the regulations should be amended to provide exceptions for certain modifications of commercial mortgage loans. In doing so, the IRS and Treasury are considering whether such changes would be consistent with the policy underlying existing regulatory provisions and Congressional intent in enacting the REMIC rules.
III. REQUEST FOR SUBMISSIONS

A. In General

The determination of whether to amend the REMIC rules requires extensive legal and policy analysis, as well as a better understanding of commercial mortgage securities industry practices. Consequently, the IRS and Treasury are requesting written submissions from taxpayers, industry associations, and other interested parties to aid the IRS and Treasury in determining whether it is appropriate to amend the REMIC regulations by expanding the list of permitted loan modifications to include certain modifications incurred in connection with commercial mortgages.

B. Format of Submissions

Submissions should include draft changes to the REMIC regulations and a policy memorandum. It is anticipated that the draft amendment will include proposed exceptions for new types of permissible loan modifications that reflect routine industry practices in connection with commercial mortgage loans.

The policy memorandum should discuss:

1. the evolution of market practices in the securitization of commercial mortgages in REMIC form;
2. the relevant REMIC policy considerations affecting restrictions on mortgage loan modifications;
3. the authority under current law for amending the regulations to include exceptions for commercial mortgages;
4. the relationship between the section 1001 modification rules and the separate REMIC modification rules;
5. an analysis of the extent to which the four existing exceptions for mortgages and any proposed exceptions for commercial mortgages constitute departures from the section 1001 modification rules;
6. the purpose and background of the four existing exceptions for modifications of mortgages in the REMIC modification rules (including policies that might favor allowing assumptions and waivers of due on sale clauses in programs intending to assist residential housing acquisitions (e.g., tax-exempt single family housing bonds, VA & FHA insured mortgages));
7. examples of what are considered to be common changes requested by borrowers to the terms of commercial mortgages and an explanation of why such changes are requested by borrowers;
8. an explanation of each proposed exception for commercial mortgages, including (i) how each proposed exception is consistent with the underlying existing regulatory provisions and Congressional intent in enacting the REMIC rules, (ii) whether the proposed exception relates to a common change; and (iii) how each proposed exception would accommodate a legitimate business concern;
9. each proposed exception illustrated by one or more examples;
10. whether there are alternatives to resolve industry issues related to commercial mortgage loan modifications other than through amending the regulations and the feasibility of such alternatives (e.g., drafting documents to permit certain changes to the terms of the commercial mortgage loan to avoid triggering a significant modification under section 1.1001–3);
11. identification of the types of taxpayers and other interested persons who are affected by the inability to modify commercial mortgage loans once the loan is placed in a REMIC and how they are affected;
12. an estimate of how many taxpayers and other interested persons are directly and indirectly affected by an inability to modify commercial mortgage loans;
13. potential consequences to the industry if changes are not made to the regulations to permit certain changes to the terms of the commercial mortgage loans; and
14. because some or all of the proposed exceptions for commercial mortgage loans will likely constitute a significant modification under section 1.1001–3, a discussion of the resulting tax consequences to the REMIC of deemed exchange treatment under section 1001 (e.g., how would the existing REMIC rules treat a gain or loss from a deemed exchange).

C. Communication with Submitting Parties during the Drafting Process

Written submissions should fully develop the issues set forth in part III., B., above. A dialogue between submitting parties and IRS and Treasury personnel during the drafting process may help ensure that submissions are as comprehensive as possible. Consequently, the IRS and Treasury encourage submitting parties to contact or meet with IRS and Treasury personnel during the initial development of their submissions.

IV. IRS AND TREASURY REVIEW OF SUBMISSIONS

A. Meetings with a Submitting Party

A submitting party may be asked to meet informally with personnel from IRS and Treasury. These meetings are intended to be used to explore the proposals and the analysis supporting those proposals set forth in a written submission and to gather additional facts and information. Discussions at these meetings may focus on the legal and policy justifications for each proposal, relevant industry practices, and any other issues of concern raised by IRS and Treasury personnel. At the end of these meetings, the IRS and Treasury may request a submitting party to provide additional factual development or legal research. The IRS and Treasury may also request additional meetings to the extent necessary to clarify any remaining issues.

Any solicitation of input from interested persons will be done within the requirements of the Federal Advisory Committee Act. The IRS does not intend to form advisory committees during this process. Although input is welcome, interested parties will not be invited to enter into negotiations or to participate in the decision-making process with respect to the proposed resolution of any issue.

B. IRS and Treasury Review and Decision-Making

After IRS and Treasury personnel have met with submitting parties and have been provided with any additional information requested, IRS and Treasury personnel will further review all submitted material, and develop any additional legal and policy analysis. After the review process is completed, the IRS and Treasury will decide whether it is appropriate to publish guidance that permits certain modifications to commercial real estate loans. If guidance is appropriate, the IRS and Treasury intend to publish proposed amendments to the REMIC regulations permitting additional types of modifications to commercial real estate loans.
V. DEADLINE AND ADDRESS FOR SUBMISSIONS

Written submissions should be submitted no later than Monday, April 30, 2007, to Internal Revenue Service, CC:PA:LPD:RU (Notice 2007–17), room 5203, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:RU (Notice 2007–17), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC 20224. Alternatively, submissions may be submitted via the Internet at Notice.Comments@irsounsel.treas.gov (Notice 2007–17). All submissions will be available for public inspection and copying in their entirety. Therefore, submissions received by the IRS and Treasury should not include taxpayer-specific information of a confidential nature. Submissions should include the name and telephone number of a person to contact.

VI. DRAFTING INFORMATION

The principal author of this notice is Diana Imholtz of the Office of Associate Chief Counsel (Financial Institutions and Products). For further information regarding this notice, contact Ms. Imholtz at 202–622–3930 (not a toll-free call).

Reporting on Acquisitions of Interests in Insurance Contracts in Which Certain Tax-Exempt Organizations Hold an Interest

Notice 2007–24

PURPOSE

This notice invites public comments on draft IRS forms to implement a new information reporting requirement for charities and certain other entities with respect to certain structured insurance contracts explained below. Public comments are also invited with respect to a Congressionally mandated study being conducted by the Department of the Treasury (the Treasury) and the Internal Revenue Service (the Service). The new reporting requirements and study are required by section 6050V of the Internal Revenue Code (the Code), which was added by section 1211 of the Pension Protection Act of 2006, Pub. L. No. 109–280, 120 Stat. 780 (2006) (PPA). In general, section 1211 of the PPA imposes a new information reporting requirement on organizations (including certain government entities) to which contributions are deductible for Federal income, estate or gift tax purposes and which acquire an applicable insurance contract in a reportable acquisition after August 17, 2006, but on or before August 17, 2008. To enable these organizations to satisfy the requirements of section 6050V, the Treasury and the Service designed Form 8921, Transactions Involving a Pool of Applicable Insurance Contracts, and Form 8922, Applicable Insurance Contract Information Return (For Tax-Exempt Organizations and Government Entities under Section 6050V). Copies of the draft forms, and their instructions, are attached to this notice. The information collected on the forms and the public comments will assist the Treasury and the Service in conducting the study mandated under section 1211 of the PPA.

BACKGROUND

Recently, there has been an increase in transactions involving the acquisition of life insurance contracts under arrangements in which both a tax-exempt organization and private investors have an interest in a contract. Under such arrangements, private investors often provide capital used to fund the purchase of the life insurance contracts (and, sometimes, annuity and endowment contracts). Both the private investors and the tax-exempt organization have an interest, directly or indirectly, in the contracts and receive cash, either while the contracts are in force or upon the death of the insured individual.

LEGISLATION

Section 6050V of the Code requires each applicable exempt organization that makes a reportable acquisition of an applicable insurance contract to file an information return at a prescribed time and in a prescribed form. The information reporting requirement applies to reportable acquisitions after August 17, 2006, but before August 17, 2008. Penalties under sections 6721 and 6724(d)(1)(B)(iv) apply to applicable exempt organizations that do not file an information return as required under section 6050V.

For purposes of section 6050V of the Code, an applicable exempt organization is generally a religious, charitable, scientific, literary, educational, amateur sports or similar organization, a fraternal society operating on a lodge system, a governmental organization (including an Indian Tribal Government), a Veterans’ organization, a cemetery company, or an employee stock ownership plan. A reportable acquisition is the acquisition by an applicable exempt organization of a direct or indirect interest in an applicable insurance contract in any case in which the acquisition is a part of a structured transaction involving a pool of such contracts. An applicable insurance contract is any life insurance, annuity, or endowment contract in which both an applicable exempt organization and a person other than an applicable exempt organization have directly or indirectly held an interest (whether or not at the same time). Exceptions apply in the case of persons with an insurable interest in the insured independent of the applicable exempt organization, named beneficiaries, or in limited circumstances, trust beneficiaries or trustees. For example, under section 6050V(d)(2)(B)(ii), an insurance contract is not an applicable insurance contract if the applicable exempt organization’s sole interest in the contract is as a named beneficiary.

The Treasury and the Service intend that Form 8921 will be used to report information to the Service about structured transactions under which there have been reportable acquisitions of applicable insurance contracts made by an applicable exempt organization. Form 8922 will be used to report information to the Service about the applicable insurance contracts that are part of a structured transaction required to be reported on a Form 8921.

Generally, on Form 8921, an applicable exempt organization would:

- Report information on the transaction itself, including information about the applicable exempt organization, other participants in the transaction, and the cash flows associated with the transaction.
Assign a unique structured transaction identifier (STI) to each transaction as provided on the form and the instructions.

Provide a description of the allocation formulas, interest rates, and other terms that govern the financial arrangement between the applicable exempt organization and the other participants in the transaction.

Attach copies of documents related to the reportable acquisition, including any contracts covering the relationships between the applicable exempt organization and the persons other than the applicable exempt organization.

Attach a representative copy of the applicable insurance contract.

Generally, on Form 8922 an applicable exempt organization would:

- Report information on the underlying applicable insurance contracts, including information about the issuers of the contracts and the individuals insured under the contracts.
- Use the STI assigned on Form 8921 that specifically relates to the underlying applicable insurance contracts.
- Attach a representative copy of the applicable insurance contract.

It is anticipated that a separate Form 8922 will be required with respect to a single transaction if the transaction involves more than one issuer, or more than one type of applicable insurance contract.

In addition to imposing the new information reporting requirements, section 1211 of the PPA requires the Treasury and the Service to undertake a study on the use by applicable exempt organizations of applicable insurance contracts for the purpose of sharing with investors the benefits of the applicable exempt organization’s insurable interest in individuals insured under such contracts. It also requires the Treasury and the Service to address in the study whether these activities are consistent with the tax-exempt status of certain applicable exempt organizations. The study may address whether such arrangements are or may be used to improperly shelter income from tax. The study will be based, in part, on information received from applicable exempt organizations on Forms 8921 and 8922 and the public comments. A report on the study is due to the Senate Finance Committee and the House Ways and Means Committee in 2009.

REQUESTS FOR PUBLIC COMMENT

The Treasury and the Service request comments on draft Forms 8921 and 8922. In addition to comments on the draft forms more generally, the Treasury and the Service specifically request comments on (i) the clarity of the forms and instructions and how they can be made easier to understand, (ii) the availability of the information that is requested on the forms without new or additional recordkeeping on the part of the filers, (iii) the relevance of the requested information to the study mandated by section 1211 of the PPA, (iv) the use of such structured insurance transactions to improperly shelter income from tax, (v) the meaning of the term “direct or indirect interest” in an applicable insurance contract, (vi) the meaning of the term “structured transaction involving a pool” of applicable insurance contracts, and (vii) the application of the unrelated business income tax under section 511 of the Code on the inside buildup of income.

The Treasury and the Service also request comments more generally to assist in the required study, especially on: (i) the purpose of transactions that are the subject of the study, other than to raise money for the applicable exempt organizations, (ii) the use of life insurance and annuity contracts by applicable exempt organizations in transactions that do not involve the participation of persons that are not tax-exempt, and (iii) in the case of an applicable insurance contract in which a charity, as defined under State law, has an interest, the appropriate treatment of amounts received by the charity as a death benefit in light of (A) the charity’s role in the transaction, (B) how the charity financed the acquisition of its interest, (C) whether the charity’s activities with respect to the contract are substantially related to the charity’s exempt purpose or function, and (D) any other relevant factors.

Written comments on draft Forms 8921 and 8922 and the study mandated under section 1211 of the PPA should be sent to: CC:PA:LPD:PR (Notice 2007–24), Room 5203, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, D.C. 20044. Alternatively, comments may be hand delivered between the hours of 8:00 a.m. and 4:00 p.m. Monday to Friday to CC:PA:LPD:PR (Notice 2007–24), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, D.C. Comments may also be transmitted electronically via the following e-mail address: Notice.Comments@irs.counsel.treas.gov. Please include “Notice 2007–24” in the subject line of any electronic communications.

All comments will be available for public inspection and copying. Because organizations will need to begin filing Forms 8921 and 8922 as soon as possible in 2007, comments, if any, on Forms 8921 and 8922 must be received by March 16, 2007.

Written comments on the study mandated under section 1211 of the PPA should be received by August 22, 2007.

DRAFTING INFORMATION

The principal author of this notice is Stephen J. Coleman of the Office of Associate Chief Counsel (Procedure & Administration). For further information regarding this notice, contact Stephen J. Coleman at (202) 622–4910 (not a toll-free call).
# Transaction Involving a Pool of Applicable Insurance Contracts

(For Tax-Exempt Organizations and Government Entities under Section 6050V)

See instructions for the required filing date.

<table>
<thead>
<tr>
<th>Structured transaction date</th>
<th>Structured transaction identifier (STI)</th>
<th>Amended Form 8921</th>
</tr>
</thead>
</table>

4 Name of organization

Number and street (or P.O. Box if mail is not delivered to street address)

City or town, state or country, and ZIP+4

Internet address

State/Country in which organized

5 Organization’s role in STI (check all that apply):

- [ ] Contract owner
- [ ] Contract Beneficiary
- [ ] Provide insurable interest
- [ ] Other

6 Check the appropriate box identifying your type of organization

- [ ] Religious, charitable, scientific, literary, educational, amateur sports, or similar organization
- [ ] Governmental organization
- [ ] Fraternal society operating on a lodge system
- [ ] Indian tribal government
- [ ] Veterans’ organization
- [ ] Cemetery company
- [ ] Employee stock ownership plan

7 Persons (other than your organization) known to hold (directly or indirectly) an interest in the applicable insurance contracts or who otherwise receive amounts from the section 6050V structured transaction. Do not include insureds. Attach additional sheets, if necessary.

<table>
<thead>
<tr>
<th>a Name</th>
<th>b Address</th>
<th>c Role in structured transaction (Check all that apply.)</th>
<th>d Legal form</th>
<th>e Check if applicable</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>[ ] Lender</td>
<td>[ ] Individual Corporation</td>
<td>Foreign</td>
</tr>
<tr>
<td></td>
<td></td>
<td>[ ] Investor</td>
<td>[ ] Partner</td>
<td>Tax-Exempt</td>
</tr>
<tr>
<td></td>
<td></td>
<td>[ ] Broker/Adviser</td>
<td>[ ] Trust</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[ ] Contract Owner</td>
<td>[ ] Government</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[ ] Contract Beneficiary</td>
<td>[ ] Other</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>[ ] Other</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

For Paperwork Reduction Act Notice, see separate instructions.

Cat. No. 37739X Form 8921 (3-2007)
<table>
<thead>
<tr>
<th>8</th>
<th>Premiums or other consideration</th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>9</td>
<td>Insurance or annuity benefits</td>
<td>a</td>
<td>Death/Endowment benefits</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>b</td>
<td>Annuity payments</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>c</td>
<td>Withdrawals/surrenders (see instructions)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>d</td>
<td>Policy loans</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>e</td>
<td>Other insurance contract proceeds</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>f</td>
<td>Total. Add lines 12a through 12e</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Amounts received or to be received (directly or indirectly) by your organization from other participants in the structured transaction</td>
<td>a</td>
<td>Received from lenders</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>b</td>
<td>Received from investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>c</td>
<td>Received from other parties</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>d</td>
<td>Total. Add lines 13a through 13c</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Amounts paid or to be paid (directly or indirectly) by your organization to other participants in the structured transaction</td>
<td>a</td>
<td>Paid to lenders</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>b</td>
<td>Paid to investors</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>c</td>
<td>Paid to other parties (see instructions)</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>d</td>
<td>Total. Add lines 14a through 14c</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Describe the section 6050V structured transaction (see instructions). Continue on separate sheet(s), if necessary.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Attach copies of related documents, including any contracts governing the relationships between the applicable exempt organization and persons other than applicable exempt organizations that have directly or indirectly held an interest in the applicable insurance contracts, and promotional materials (including financial projections) provided to your organization, to your donors, or to other persons who have directly or indirectly held an interest in the applicable insurance contracts.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of Authorized Person

Date

Type or print name

Title

Telephone number
**Part I**  
A separate Form 8922 must be filed for each different issuer and for each different contract type and form. See instructions for the required filing date(s).

<table>
<thead>
<tr>
<th></th>
<th>Structured transaction date</th>
<th>Structured transaction identifier</th>
<th>Sequence number (see instructions)</th>
<th>Check if amended</th>
<th>Taxpayer identification number (TIN)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Name of organization</td>
<td>Number and street (or P.O. Box if mail is not delivered to street address)</td>
<td>Room/Suite</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>City or town, state or country, and ZIP+4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Name of insurance contracts issuer</td>
<td>Number and street (or P.O. Box if mail is not delivered to street address)</td>
<td>Room/Suite</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>City or town, state or country, and ZIP+4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6 Type of applicable insurance contract  
   - a ☐ Life insurance (including contracts with an endowment feature)  
   - b ☐ Deferred annuity  
   - c ☐ Immediate annuity

7 Contract form identifier __________________________________________________________________

8a Owner(s) of the contracts:  
   - a ☐ Your organization  
   - b ☐ Other __________________________

8b Beneficiaries of the contracts:  
   - a ☐ Your organization  
   - b ☐ Other __________________________

9a Are premiums fixed by the insurance contracts or at the discretion of the contract owners?  
   - a ☐ Fixed  
   - b ☐ Discretionary  

9b If fixed contracts, enter the premium term in year(s) __________, or  
9c If for the life of the insured, check here ☐

10 Investment options (check all that apply):  
   - a ☐ No option  
   - b ☐ Guaranteed interest funds  
   - c ☐ Bond or equity funds  
   - d ☐ Other

11a Do the contracts endow?  
   - a ☐ Yes  
   - b ☐ No

11b If "Yes," when?  
   - a ☐ After _______ years, or  
   - b ☐ at age _______ of the insured

For lines 12 through 15, check the boxes that apply.

12 ☐ Contracts have cash surrender values

13 ☐ Policy loans are available from these contracts

14 ☐ Partial cash withdrawals are available from these contracts

15 ☐ Contracts are immediate annuities:  
   - a Payments are ☐ fixed  ☐ variable  
   - b If payments are inflation indexed, check here ☐

16 Attach representative copy of the applicable insurance contract covered by this Form 8922.
17 List insureds or annuitants covered by the applicable insurance contracts to which this Form 8922 applies. Attach additional sheets if necessary.

<table>
<thead>
<tr>
<th>a Insured or annuitant covered (see instructions)</th>
<th>b Social security number (SSN)</th>
<th>c Gender</th>
<th>d Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>e Relation to organization resulting in an insurable interest:</td>
<td>f Number of Insured</td>
<td>of</td>
<td></td>
</tr>
<tr>
<td>Donor</td>
<td>Other_IDENTIFIER</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Donations received within past 12 months from insureds</td>
<td>3 First-year premium or other consideration</td>
<td>4 Death or endowment benefit, if life insurance</td>
<td>5 Monthly annuity, if immediate annuity</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>b Insured or annuitant covered (see instructions)</th>
<th>c Gender</th>
<th>d Age</th>
</tr>
</thead>
<tbody>
<tr>
<td>e Relation to organization resulting in an insurable interest:</td>
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</tr>
<tr>
<td>Donor</td>
<td>Other_IDENTIFIER</td>
</tr>
<tr>
<td>2 Donations received within past 12 months from insureds</td>
<td>3 First-year premium or other consideration</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>d Insured or annuitant covered (see instructions)</th>
<th>e Relation to organization resulting in an insurable interest:</th>
<th>f Number of Insured</th>
<th>of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Donor</td>
<td>Other_IDENTIFIER</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Donations received within past 12 months from insureds</td>
<td>3 First-year premium or other consideration</td>
<td>4 Death or endowment benefit, if life insurance</td>
<td>5 Monthly annuity, if immediate annuity</td>
</tr>
</tbody>
</table>

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<th>of</th>
</tr>
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<tbody>
<tr>
<td>Donor</td>
<td>Other_IDENTIFIER</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Donations received within past 12 months from insureds</td>
<td>3 First-year premium or other consideration</td>
<td>4 Death or endowment benefit, if life insurance</td>
<td>5 Monthly annuity, if immediate annuity</td>
</tr>
</tbody>
</table>

Part I

Please Sign Here

Under penalties of perjury, I declare that I have examined this return, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete.

Signature of authorized person

Date

Type or print name

Title

Telephone number

Form 8922 (3-2007)

Printed on recycled paper
# Instructions for Forms 8921 and 8922

(March 2007)

Section references are to the Internal Revenue Code unless otherwise noted.

## General Instructions

### Purpose of Forms
Generally, an applicable exempt organization must file a Form 8921 for each structured transaction under which it makes reportable acquisitions of applicable insurance contracts. The applicable exempt organization must file a Form 8922 for each type of insurance contract and each contract form that is issued as part of a structured transaction required to be reported on Form 8921. See *When and Where to File* below regarding the filing deadlines for Forms 8921 and 8922. For more information on the reporting requirements, see section 6050V. See *Definitions* below for terms used in these instructions.

### Who Must File
Applicable exempt organizations must file Forms 8921 and 8922 if they acquire a direct or indirect interest in an applicable insurance contract after August 17, 2006, and on or before August 17, 2008. Form 8921 must be filed (regardless of the date the structured transaction was entered into) if any applicable insurance contract is acquired after August 17, 2006, and on or before August 17, 2008.

### How to Complete Forms
In order to be considered complete, Forms 8921 and 8922 must be completed in their entirety with all required attachments. If the information required exceeds the space provided, attach additional sheets. The additional sheets must be in the same order as the lines to which they correspond. Include your organization’s name and the structured transaction identifier (STI) at the top of each additional sheet.

Round off cents to whole dollars.

### When and Where to File
If an applicable exempt organization makes a reportable acquisition after August 17, 2006, and on or before August 17, 2008, it must file a Form 8921 within 80 days of making the first such reportable acquisition relating to each structured transaction; however, no forms are required to be filed before May 1, 2007. A separate Form 8922 must be filed for each type of applicable insurance contract issued as part of the structured transaction and for each contract form. Contract forms differ if the contract terms (including premium, investment, or withdrawal options) differ.

If any information required by Form 8921 is unavailable at the time of its initial filing, or if any information already provided changes, then an amended Form 8921 must be filed by October 1, 2007 (with respect to changes effected on or before August 17, 2007), or by October 1, 2008 (with respect to changes effected on or before August 17, 2008, but after August 17, 2007).

Reportable acquisitions relating to each type or form of insurance contract must be reported on separate Forms 8922. If any information required by Form 8922 is unavailable at the time of initial filing, an amended Form 8922 must be filed. Forms 8922 must be filed according to the following schedule.

<table>
<thead>
<tr>
<th>IF reportable acquisitions were made after...</th>
<th>AND on or before...</th>
<th>THEN file Form 8922 by...</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 17, 2006,</td>
<td>February 17, 2007,</td>
<td>May 1, 2007</td>
</tr>
</tbody>
</table>

### Where to send
Send Forms 8921 and 8922 to the following address:

**Internal Revenue Service**

Ogden, UT 84401-0027

If filing using a private delivery service, send Forms 8921 and 8922 to the following address:

**Internal Revenue Service**

1973 N. Rulon White Blvd.

Ogden, UT 84404

### Penalty
There is a monetary penalty under section 6721 for the failure to file a required Form 8921 or Form 8922 on or before the required filing date. See *When and Where to File*. Other penalties are imposed for the failure to include all information and required attachments, or for the inclusion of incorrect information. The penalty is generally $50 per failure, not to exceed $250,000 during any calendar year, but may be less in certain cases. See sections 6721 and 6724(d)(1)(B)(iv).

If one or more failures are due to intentional disregard of the filing requirement (or the correct information reporting requirement), then the penalty per failure is the greater of (a) $100, or (b) 10% of the value of the benefit of any applicable insurance contract when information is required to be included on the return. In this case, the penalty imposed for such intentional disregard is not taken into account in applying any calendar year limitation. See section 6721(e).

No penalty shall be imposed for any failure if it is shown that such failure is due to reasonable cause and not to willful neglect. See section 6724(a).

### Definitions

#### Applicable Exempt Organization
An applicable exempt organization is generally a religious, charitable, scientific, literary, educational, amateur sports or similar organization, a governmental organization, a fraternal society operating on a lodge system, a veterans' organization, an Indian tribal government, a cemetery company, or an employee stock ownership plan. See section 6050V(d)(3). The term "organization" when used in these instructions refers to an applicable exempt organization.

#### Applicable Insurance Contract
An applicable insurance contract is any life insurance, annuity, or endowment contract in which both an applicable exempt organization and a person other than an applicable exempt organization has an interest as owner and beneficiary.
organization have directly or indirectly held an interest (whether or not at the same time). However, a contract is not an applicable insurance contract if:
- Each person directly or indirectly holding an interest in the contract (other than an applicable exempt organization) has an insurable interest in the contract’s insured that is independent of the applicable exempt organization.
- The sole interest in the contract of each involved person is as a named beneficiary, or
- Under certain circumstances, the sole interest in the contract of each person other than an applicable exempt organization is a beneficiary of one or more trusts holding an interest in the contract, or a trustee who holds an interest in the contract solely in a fiduciary capacity. See section 6050V(d)(2).

**Reportable Acquisition**

A reportable acquisition is one in which an acquisition is made of a direct or indirect interest in an applicable insurance contract when the acquisition is a part of a structured transaction involving a pool of such contracts.

**Structured Transaction**

A structured transaction is any transaction in which an applicable exempt organization acquires a direct or indirect interest in a pool of applicable insurance contracts.

**Structured Transaction Identifier (STI)**

A structured transaction identifier, or STI, is a 13-digit number used to identify the structured transaction for which a Form 8921 is being filed. See instructions for Line 2 of Form 8921.

---

**Specific Instructions for Form 8921**

**Part I**

**Line 1**
Enter the date that your organization entered into the structured transaction.

**Line 2**
Enter a structured transaction identifier (STI). The STI is to be used to identify the section 6050V structured transaction for which this Form 8921 and related Forms 8922 are being filed. It should be entered in Line 2 of all Forms 8922 associated with this particular section 6050V structured transaction, on all additional sheets attached to Form 8921 or to Form 8922, and on all other required attachments to Form 8921 or Form 8922.

The STI consists of two parts. The first part (before the dash) is your organization’s nine-digit taxpayer identification number. The second part of the STI is a four-digit sequence number that is unique for each structured transaction. For example, if this is the sole structured transaction entered into by your organization, enter 0001 as the sequence number. If your organization is a party to a second structured transaction, enter 0002 for that transaction.

**Line 3**
Check this box if this is an amended Form 8921. An amended form must be filed if there is any material change in the terms or relationships in a structured transaction. An amended form must also be filed in order to correct any errors in an Initial Form 8921 filed by your organization.

**Line 4**
Enter the name, taxpayer identification number, mailing address, internet address, and the state or country in which your organization is organized.

**Line 5**
Check all boxes that describe your organization’s role in the structured transaction.

**Line 6**
Columns a and b. Enter the name and mailing address of any person known to hold (directly or indirectly) an interest in the applicable insurance contracts or who otherwise have received or will receive amounts from the structured transaction being reported on this Form 8921. Do not include your organization. Do not list any insured, unless that person has an interest in the applicable insurance contracts or the structured transaction other than as an Insured. Attach additional sheets, if necessary.

**Line 7**

**Line 8**
Report the premiums or other considerations that have been paid or are expected to be paid with respect to the applicable insurance contracts covered by the structured transaction. Include amounts paid by your organization and amounts paid to insurers by other parties to the structured transaction.

Do not reduce gross premiums by amounts received as policyholder dividends, policy loans, cash value withdrawals, or policy surrenders.

**Line 9**
Report insurance or annuity benefit amounts received (or expected to be received) from the applicable insurance contracts covered by the structured transaction. Include all amounts to be received from the insurance contracts by any parties to the structured transaction.

**Line 9c**
Report amounts received (or expected to be received) as withdrawals of cash values, contract surrenders (net of any surrender charges or adjustments), or as policyholder dividends paid in cash or deposited in an interest bearing account. Do not include policyholder dividends used to buy supplemental insurance.

**Line 9e**
Report any other source of receipts associated with the applicable insurance contracts.

Combine all amounts from lines 9a through 9e and enter on line 9f.

**Line 10**
Report amounts received (or expected to be received) by your organization under the structured transaction. Include all amounts to be received by your organization from any other parties to the structured transaction. Any amounts paid by other parties directly to insurance companies as premiums or other consideration should also be included. Also treat any amounts paid by other parties directly to brokers, advisors, or similar persons as amounts received by your organization. See Direct payments to brokers and similar persons below.

**Line 10b**
Report amounts received or expected to be received from persons (other than lenders) that furnish funds in the anticipation of earning an investment return.

---
Line 10c. Report amounts received (or expected to be received) from persons other than lenders or investors (for example, brokers or advisors).

Lines 11a through 11d
Report amounts paid (or expected to be paid) under the structured transaction by your organization or directly from an applicable insurance contract. Include all amounts to be paid by your organization to any other parties to the structured transaction. Any amounts paid to other parties directly by insurance companies as benefits or other payments from applicable insurance contracts should also be included. Also treat any amounts paid by other parties directly to brokers, advisors, or similar parties as amounts paid by your organization. See Direct payments to brokers and similar persons below.

How to distribute amounts. Distribute amounts according to whomever ultimately receives payment. For example, if amounts are first paid to a trust or other account and are ultimately distributed to one or more investors and lenders, report the initial payment amount as being paid to the investors or lenders, respectively.

Line 11a. Report amounts paid (or expected to be paid) to persons participating as lenders in the structured transaction. Reported amounts should include both payments of interest and repayments of principal.

Line 11b. Report amounts paid (or expected to be paid) to persons (other than lenders) that furnish funds in the anticipation of earning an investment return. Reported amounts should include both earnings and payments of invested principal.

Line 11c. Report any amounts paid (or expected to be paid) to persons other than lenders or investors (for example, brokers or advisors).

Direct payments to brokers and similar persons
If persons to the structured transaction contribute to a trust or other arrangement that pays out fees or similar monies to brokers or other persons (without going through your organization or an applicable insurance contract), report these amounts as follows. Report the amounts as amounts received by your organization on the appropriate line 10(a) through 10(c). Also, include these amounts as funds paid by your organization to other parties to the structured transaction (line 11(c)).

Line 12
Provide a description of the structured transaction. Include all facts that may be relevant to understanding the structure, economics, and tax consequences of the structured transaction. In particular:

- Identify the persons providing funds to pay insurance premiums and explain the determination of their share of such premiums;
- Report the aggregate anticipated death or annuity benefits amounts to be paid under the transaction and explain the allocation of these amounts to the parties to the structured transaction;
- State explicitly any percentages, formulas, interest rates, dollar amounts, etc. used to allocate the financial obligations of the interested persons and the distribution of earnings or insurance benefits to such persons; and
- Identify recipients or payers of any residual surplus or deficit. If interest rates are fixed by contract, provide the specific rates and terms; if variable, indicate the index(es) and spread(s).

Continue on separate sheet(s) if necessary.

Line 13
Attach copies of all documents related to the section 6505V structured transaction. Include any documents or contracts governing the relationships amongst any and all parties to the structured transaction. Attach all materials used to promote or inform about the structured transaction, including any financial projections, that were given to your organization, donors, prospective insureds, and other parties that had an interest in the structured transaction.

Part II
An authorized individual must sign and date the Form 8921 for your organization. Enter that individual’s name, title, and telephone number in the spaces provided.

Specific Instructions for Form 8922

Part I

Line 1
Enter the date on which your organization entered into the structured transaction, as reported on line 1 of the filed Form 8921.

Line 2
Enter the STI assigned to the structured transaction for which this Form 8922 is being filed. See line 2 of the Specific Instructions for Form 8921. It should also be entered on all additional sheets attached to Form 8922 and on all other required attachments to Form 8922.

Line 3
An additional Form 8922 must be filed if there are additional reportable acquisitions relating to a given structured transaction that have not been reported on previously filed Forms 8922. Enter in line 3a a four-digit Form 8922 sequence number for this Form 8922. For example, if this is the initial Form 8922 associated with a Form 8921 (uniquely identified by its structured transaction identifier (STI)), enter 0001. Enter 0002 if this is the second Form 8922 filed with respect to the same Form 8921, and so forth. For the filing schedule for Forms 8922, see When and Where to File on page 1.

An amended Form 8922 must also be filed in order to correct any errors on previously filed Forms 8922. Enter the same Form 8922 sequence number on the amended form as was entered on the original. Check the box in line 3b if this is an amended Form 8922. Amended Forms 8922 should be filed in a timely manner upon discovery of the error(s).

Line 4
Enter the name, mailing address, and taxpayer identification number of your organization.

Line 5
Enter the name, mailing address, and taxpayer identification number of the issuer of the insurance contracts being reported on this Form 8922.

Line 6
Check the box that appropriately identifies the type of applicable insurance contract being reported on this Form 8922. An immediate annuity is a contract under which the first benefit payment is due in one payment interval (for example, monthly) from the date of purchase. Under a deferred annuity, payments begin, if at all, at a later date.

Line 7
Enter a contract form identifier (number or name) that is used to identify the contract form being reported on this Form 8922. A Form 8922 need not be filed for each contract, but a Form 8922 must be filed for each different contract form. Contract forms differ if the contract terms (including premium, investment, or withdrawal options) differ. Use this identifier on any subsequent Form 8922 that reports additional contracts using that particular contract form.

Line 8a
Check the “Your organization” box if your organization is an owner of the contracts being reported on this Form 8922. If other persons are contract owners, check the “Other” box, and enter their names in the space provided to the right of the box.

Line 8b
Check the “Your organization” box if your organization is a beneficiary of the contracts being reported on this Form 8922. If
other persons are contract beneficiaries, check the "other" box, and enter their names in the space provided to the right of the box.

**Line 9**
Check the "Fixed" box if premium obligations are fixed in amount and periodicity by the insurance contract. Check the "Discretionary" box if premium amounts and timing are determined at the discretion of the contract owner.

If premiums are fixed by contract, enter the premium term in years on line 9a. If the premiums are to be paid over the life of the insured(s), check box for the life of the insured.

**Line 10**
Identify the available investment options under the contract. Check all boxes that apply, even if one or more options are not chosen.

<table>
<thead>
<tr>
<th>IF...</th>
<th>THEN check box for...</th>
</tr>
</thead>
<tbody>
<tr>
<td>No specified investment option is available (for example, where only a guaranteed cash value schedule is specified), regardless of whether or not policyholder dividends may be paid.</td>
<td>No Option</td>
</tr>
<tr>
<td>Fixed or variable rates of interest are specified in the contract, but there is no possibility that the market value of the contract cash value may fall due to changes in market pricing of shares.</td>
<td>Guaranteed Interest Funds</td>
</tr>
<tr>
<td>Investments in bond, equity, or blended funds are available, and where the cash value of the contract depends on the market value of the underlying investments.</td>
<td>Bonds or Equity Funds</td>
</tr>
<tr>
<td>The contract provides other types of investment options, including options that offer additional guarantees as to the contract cash value (for example, contracts that guarantee a fixed or variable floor on cash values in situations where the market value of the underlying investments declines).</td>
<td>Other</td>
</tr>
</tbody>
</table>

**Lines 11a and 11b**
Check the box in line 11a if the contracts have an endowment feature. If so, check the appropriate box in line 11b that best describes the feature, and enter the requested information. An endowment feature is one that pays a benefit if the insured survives to a specified date or age. The ability to receive the contract's cash value on demand is not an endowment feature.

**Line 15**
Complete these lines if the contract type is an immediate annuity. Check if the payments are fixed or variable. Payments are variable if dependent upon a fund value or other index (other than a price index).

**Line 17**
List the insureds covered by the applicable insurance contracts to which this Form 8922 pertains. Attach additional sheets if necessary.

**Box 1e. Relation to organization resulting in an insurable interest.** If the insured is a donor of your organization, and donor status provides an insurable status with respect to your organization in your state or other jurisdiction, then check the "Donor" box. Enter the total amount of donations received from the insured within the past 12 months prior to his or her becoming an insured in item 2. Otherwise, check the "Other" box and write a brief description of the relationship that establishes an insurable interest in the insured by your organization.

**Box 1f. Number of insured.** Enter the number of the insured for each contract. If the contract insures a single individual, enter "1" of "1." However, if a single contract covers more than one insured, list each insured separately, but consecutively, and enter the number of the insured. For example, if a life insurance contract is a "second-to-die policy," then list the two insureds consecutively, enter "1" of "2" for the first listed individual and "2" of "2" for the second listed individual. For policies with multiple insureds, enter the amounts for Boxes 3 to 5 on the line containing the first named insured.

**Box 3. First-year premium or other consideration.** Enter the premiums paid or due in the first policy year (that is, those premiums prior to the first policy anniversary date) on the applicable insurance contract for each named insured.

**Box 4. Death or endowment benefit.** If the applicable insurance contract is a life insurance contract, enter the amount of death or endowment benefits. If the amount of death benefit can change over time, enter the initial benefit amount.

**Box 5. Monthly annuity.** If the applicable insurance contract is an immediate annuity policy, enter the monthly annuity amount. If the annuity pays more or less frequently than monthly, enter the monthly equivalent amount. For example, if an annuity pays annually, enter one-twelfth of the annual amount.

**Part II**
An authorized individual must sign and date the Form 8922 for your organization. Enter that individual's name, title, and telephone number in the spaces provided.

**Paperwork Reduction Act Notice** You are not required to provide the information requested on a form that is subject to the Paperwork Reduction Act unless the form displays a valid OMB control number. Books or records relating to a form or its instructions must be retained as long as their contents may become material in the administration of any Internal Revenue law. Generally, tax returns and return information are confidential, as required by section 6103.

The time needed to complete and file these forms will vary depending on individual circumstances, such as the complexity of the section 806050 structured transaction and the number of individuals insured under the applicable insurance contracts. The estimated burden of applicable exempt organizations filing these forms is approved under the OMB control number XXXX-XXXX and is shown below.

<table>
<thead>
<tr>
<th>Recordkeeping</th>
<th>Xhrs.</th>
<th>Ymin.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Learning about the law or the form</td>
<td>X hrs.</td>
<td>Ymin.</td>
</tr>
<tr>
<td>Preparing, copying, assembling, and sending the form to the IRS</td>
<td>X hrs.</td>
<td>Ymin.</td>
</tr>
</tbody>
</table>

If you have comments concerning the accuracy of these time estimates or suggestions for making this form simpler, we would be happy to hear from you. You can write to the Internal Revenue Service, Tax Products Coordinating Committee, SE:W.CPR:MP:T:T:S:P, 1111 Constitution Ave. NW, IR-6406, Washington, DC 20224. Do not send the forms to this address. Instead, see When and Where to File on page 1.

-4-

Revised Housing Cost Amounts Eligible for Exclusion or Deduction

Notice 2007–25

SECTION 1. PURPOSE

This notice provides modifications and additions to the adjusted limitations on housing expenses published in Notice 2006–87, 2006–43 I.R.B. 766, for purposes of section 911 of the Internal Revenue Code (Code).

SECTION 2. BACKGROUND

Notice 2006–87 provides an adjusted limitation on housing expenses for a qualified individual incurring housing expenses in 2006 in one or more of the identified high cost localities to use (in lieu of the otherwise applicable limitation of $24,720) in determining his or her housing expenses under section 911(c)(2)(A) of the Code. Notice 2006–87 also requests comments on the average housing costs for specific locations that differ significantly from the amounts provided in the notice.

In response to comments received on Notice 2006–87, the Internal Revenue Service (IRS) and the Treasury Department are publishing certain modifications and additions to the 2006 housing expense table in Notice 2006–87. The adjusted limitations on housing expenses provided in section 3 supersede and replace the adjusted limitations on housing expenses for 2006 for those specific locations provided in Notice 2006–87. The adjusted limitations on housing expenses provided in section 4 address locations within countries with high housing costs that were not identified in Notice 2006–87, and provide an adjusted limitation on housing expenses for 2006 for these locations. A complete table of the adjusted limitations on housing expenses for 2006 is available on the IRS website at http://www.irs.gov/formspubs under the link “What’s Hot in forms and publications”.

The IRS and the Treasury Department continue to work on guidance for housing expenses for 2007. Based on preliminary indications, the 2007 adjusted limitations on housing expenses for some locations may be lower than the 2006 adjusted limitations on housing expenses in Notice 2006–87 for those locations. The IRS and the Treasury Department intend to provide guidance for housing expenses for 2007 as soon as possible.

SECTION 3. MODIFIED ADJUSTED LIMITATIONS ON HOUSING EXPENSES FOR SPECIFIC LOCATIONS IDENTIFIED IN NOTICE 2006–87

<table>
<thead>
<tr>
<th>Country</th>
<th>Location</th>
<th>Limitation on Housing Expenses (daily)</th>
<th>Limitation on Housing Expenses (full year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Austria</td>
<td>Vienna</td>
<td>78.97</td>
<td>28,824</td>
</tr>
<tr>
<td>Bermuda</td>
<td>Bermuda</td>
<td>197.26</td>
<td>72,000</td>
</tr>
<tr>
<td>Japan</td>
<td>Nagoya</td>
<td>103.52</td>
<td>37,786</td>
</tr>
<tr>
<td>Japan</td>
<td>Osaka-Kobe</td>
<td>145.30</td>
<td>53,036</td>
</tr>
<tr>
<td>Norway</td>
<td>Oslo</td>
<td>83.76</td>
<td>30,573</td>
</tr>
<tr>
<td>Russia</td>
<td>Moscow</td>
<td>207.45</td>
<td>75,720</td>
</tr>
<tr>
<td>Ukraine</td>
<td>Kiev</td>
<td>89.98</td>
<td>32,844</td>
</tr>
</tbody>
</table>

SECTION 4. ADJUSTED LIMITATIONS ON HOUSING EXPENSES FOR LOCATIONS NOT INCLUDED IN NOTICE 2006–87

<table>
<thead>
<tr>
<th>Country</th>
<th>Location</th>
<th>Limitation on Housing Expenses (daily)</th>
<th>Limitation on Housing Expenses (full year)</th>
</tr>
</thead>
<tbody>
<tr>
<td>China</td>
<td>Beijing</td>
<td>131.51</td>
<td>48,000</td>
</tr>
<tr>
<td>China</td>
<td>Shanghai</td>
<td>147.95</td>
<td>54,000</td>
</tr>
<tr>
<td>India</td>
<td>Mumbai</td>
<td>156.19</td>
<td>57,011</td>
</tr>
<tr>
<td>India</td>
<td>New Delhi</td>
<td>73.75</td>
<td>26,920</td>
</tr>
<tr>
<td>Indonesia</td>
<td>Jakarta</td>
<td>103.49</td>
<td>37,776</td>
</tr>
<tr>
<td>Qatar</td>
<td>Doha</td>
<td>95.30</td>
<td>34,786</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Jeddah</td>
<td>84.02</td>
<td>30,667</td>
</tr>
<tr>
<td>Saudi Arabia</td>
<td>Riyadh</td>
<td>84.02</td>
<td>30,667</td>
</tr>
</tbody>
</table>
SECTION 5. EFFECT ON OTHER DOCUMENTS

Notice 2006–87 is modified and supplemented.

SECTION 6. EFFECTIVE DATE

This notice is effective for taxable years beginning on or after January 1, 2006.

SECTION 7. DRAFTING INFORMATION

The principal author of this notice is Paul J. Carlino of the Office of Associate Chief Counsel (International). For further information regarding this notice, contact Mr. Carlino at (202) 622–3840 (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 1, §§ 6011, 6662, 6662A, 6707A; 1.6011–4.)

Rev. Proc. 2007–25

SECTION 1. PURPOSE

This revenue procedure amplifies Rev. Proc. 2005–51, 2005–2 C.B. 296, which provides guidance to persons who may be required to pay certain penalties under sections 6662(b), 6662A, or 6707A of the Internal Revenue Code, and who may be required under section 6707A(e) to disclose those penalties on reports filed with the Securities and Exchange Commission (“SEC”).

SECTION 2. BACKGROUND

.01 Section 6707A(e), as added by the American Jobs Creation Act of 2004, Pub. L. No. 108–357, 118 Stat. 1418, requires a person that is required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or is required to be consolidated with another person for purposes of those reports, to disclose in those reports for the periods specified by the Secretary the requirement to pay the penalties set forth in section 6707A(e)(2).

.02 Section 4 of Rev. Proc. 2005–51 sets forth the report on which the disclosures must be made, the information that must be disclosed, and the deadlines by which persons must make the disclosures on reports filed with the SEC in order to avoid additional penalties under section 6707A(e).

.03 Section 4.01 of Rev. Proc. 2005–51 specifically provides that a person who files SEC Form 10–K, Annual Report, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in Item 3 (Legal Proceedings) of Form 10–K the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.

.04 After the issuance of Rev. Proc. 2005–51, questions arose regarding persons required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934, or required to be consolidated with another person for purposes of those reports, but that file these periodic reports on a form other than a Form 10–K or is required to be consolidated with another person for purposes of those reports.

SECTION 3. SCOPE

This revenue procedure applies to any person required to pay any penalty described in section 2.05 of Rev. Proc. 2005–51 that is also required to file periodic reports under section 13 or 15(d) of the Securities Exchange Act of 1934 on a form other than a Form 10–K or is required to be consolidated with another person for purposes of those reports.

SECTION 4. APPLICATION

.01 A person who files Form 10–KSB, Annual Report of Small Business Issuers, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in Item 3 (Legal Proceedings) of Form 10–KSB the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.


.03 A person who files Form 20–F, Annual Report of Foreign Private Issuers, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in Item 8 (Financial Information) of Form 20–F, under the subheading “Legal Proceedings”, the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.

.04 A person who files Form 40–F, Annual Report of Certain Canadian Issuers, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in the Annual Information Form filed as part of the Form 40–F, under the subheading “Legal Proceedings”, the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.

.05 A person who files Form N–SAR, Annual Report of Registered Investment Companies, pursuant to section 13 or 15(d)
of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in Sub-Item 77E (Legal Proceedings) of Form N–SAR the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.

.06 A person who files Form N–CSR, Annual Report of Registered Investment Companies, pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934, either separately or consolidated with another person, must disclose in Item 1 (Reports to Stockholders) of Form N–CSR, under the subheading “Legal Proceedings”, the requirement to pay any penalty specified in section 2.05 of Rev. Proc. 2005–51.

.07 The same procedures described in sections 4.02 and 4.03 of Rev. Proc. 2005–51 regarding the information that must be disclosed and the deadlines by which persons must make the disclosures on reports filed with the SEC that apply to Form 10–K apply to Forms 10–KSB, 11–K, 20–F, 40–F, N–SAR, and N–CSR, as applicable.

SECTION 5. EFFECT ON OTHER DOCUMENTS


SECTION 6. PAPERWORK REDUCTION ACT

The collections of information in Rev. Proc. 2005–51 have been previously 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 1545–1956. This revenue procedure does not make substantive changes to those collections of information.

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.

SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for any penalty specified in section 2.05 of Rev. Proc. 2005–51 that relates to a return or statement the due date for which is after October 22, 2004.

SECTION 8. DRAFTING INFORMATION

The principal author of this revenue procedure is Matthew S. Cooper of the Office of the Associate Chief Counsel (Procedure & Administration). For further information regarding this revenue procedure, contact Matthew S. Cooper at (202) 622–4940 (not a toll-free call).
Part IV. Items of General Interest

Withdrawal of Notice of Proposed Rulemaking and Notice of Proposed Rulemaking

Agreements for Payment of Tax Liabilities in Installments

REG–100841–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking and notice of proposed rulemaking.


DATES: Written or electronic comments and requests for a public hearing must be received by June 4, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–100841–97), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–100841–97), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically directly to the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (indicate IRS and REG–100841–97).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, G. William Beard, (202) 622–3620; concerning submissions of comments or requests for a hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

On December 31, 1997, a notice of proposed rulemaking (REG–100841–97; 62 FR 68241) reflecting changes made to section 6159 of the Internal Revenue Code (Code) by section 202 of the Taxpayer Bill of Rights II, Public Law 104–168 (110 Stat. 1452, 1457) was published in the Federal Register. That proposed rule was not acted upon prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998 (RRA 1998), Public Law 105–206, section 3462 (112 Stat. 685, 764), which made further amendments to section 6159. Section 843 of the American Jobs Creation Act of 2004 (AJCA), Public Law 108–357 (118 Stat. 1418, 1600), also made changes to section 6159. This document amends the prior notice of proposed rulemaking. It contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) under section 6159 reflecting the amendment of the Code by RRA 1998, the Taxpayer Bill of Rights II, and the AJCA.

Installment Agreements under Section 6159

Consistent with its mission of applying the tax laws with integrity and fairness to all, the IRS generally expects that all taxpayers will pay the total amount due, regardless of amount, at the time the Code requires that the tax be paid. See Policy Statement P–5–2, Collecting Principles (Approved February 17, 2000), reprinted at IRM 1.2.1.5.2. When attempting to resolve a tax delinquency, the IRS will work with taxpayers to achieve full payment of all tax, penalties, and interest. Where payment in full cannot immediately be achieved, the IRS may allow taxpayers to pay over time through installment agreements.

Explanation of Provisions

The proposed regulations allow the IRS to enter into agreements for the full or partial payment of any unpaid tax in installments. The regulations provide rules for the submission of proposed installment agreements, the processing, acceptance, and rejection of such agreements by the IRS, the termination or modification of existing agreements, and the appeal of rejections, modifications, and terminations to the IRS Office of Appeals (Appeals). The majority of these provisions are unchanged from what was contained in the prior regulations or reflect longstanding IRS administrative practice. The rules regarding when a proposed installment agreement becomes pending, restrictions on collection activity while an agreement is pending or in effect, and the suspension of the statute of limitations for collection are nearly identical to the provisions in existing §301.6331–4. The only change was a clarification that the IRS will not be precluded from filing suit or a proof of claim in bankruptcy for the full amount of the liabilities owed, regardless of whether the installment agreement provides for full or partial payment of the liabilities at issue.

Taxpayers may request administrative review of IRS decisions to modify or terminate installment agreements pursuant to section 6159(e), added to the Code by section 202 of the Taxpayer Bill of Rights II. Taxpayers may appeal rejections of proposed installment agreements under section 7122(d), added to the Code by section 3462 of RRA 1998. The proposed regulations allow taxpayers to appeal a termination, modification, or rejection of an installment agreement to Appeals provided they request the appeal in the manner specified by the IRS.

The previous notice of proposed rulemaking contained a more detailed procedure for seeking review of decisions to terminate or modify agreements. That proposed regulation has not been adopted. These regulations contain a less detailed procedure because procedures for appealing differ depending on the IRS operating division handling the case, the size of the tax liability, or the type of tax at issue. For example, some taxpayers may be able to request an appeal by telephone while others will be required to submit a formal
written request. See Publication 1660, Collection Appeal Rights.

The proposed regulations incorporate the provisions of section 6159(c), added to the Code by section 3467 of RRA 1998. That section requires the IRS to accept a proposed installment agreement for income taxes under certain circumstances. The regulations also incorporate section 3506 of RRA 1998, which requires the IRS to send each taxpayer with an installment agreement an annual statement showing the balance due at the beginning of the year, the payments made during the year, and the remaining balance due at the end of the year.

Section 843 of the AJCA amended section 6159(a) to allow the IRS to enter into installment agreements that provide for partial (as well as full) payment of a tax liability. The proposed regulations incorporate this change. Because a partial payment installment agreement could be confused with a compromise of the liability, the proposed regulations clarify that an installment agreement does not reduce the amount of taxes, interest, or penalties owed. See H. Rep. No. 108–755, 108th Cong., 2d Sess., 2005 U.S.C.C.A.N. 1341 (October 7, 2004). The proposed regulations reflect this requirement.

The proposed regulations clarify the application of payments made pursuant to installment agreements. Consistent with Revenue Procedure 2002–26, 2002–1 C.B. 746, all payments will be applied in the best interests of the Government, unless the installment agreement provides otherwise. Current regulations provide rules for when the IRS may terminate an agreement but do not expressly provide that a taxpayer and the IRS may agree to end an agreement. The proposed regulations clarify that an installment agreement may be terminated by agreement between the taxpayer and the IRS, or may be superceded by a new agreement.

Proposed Effective Date

These regulations are proposed to be effective upon publication in the Federal Register of the final regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information under the Paperwork Reduction Act (44 U.S.C. section 3501), the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply to these regulations. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. The IRS generally requests any comments on the clarity of the proposed rule and how it may be made easier to understand. All comments will be available for public inspection and copying. A public hearing may be scheduled if requested in writing by a person that timely submits written or electronic comments. If a public hearing is scheduled, notice of the date, time, and place for the hearing will be published in the Federal Register.

Drafting Information

The principal author of these regulations is G. William Beard, Office of Associate Chief Counsel (Procedure and Administration), Collection, Bankruptcy & Summons Division.

* * * * *

Withdrawal of Proposed Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking (REG–100841–97) that was published in the Federal Register on December 31, 1997 (62 FR 68241) is withdrawn.

Proposed Amendments to the Regulations

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

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6159–0 is added to read as follows:

§301.6159–0 Table of contents.

This section lists the major captions that appear in the regulations under §301.6159–1.
§301.6159–1 Agreements for the payment of tax liabilities in installments.

(a) Authority.
(b) Procedures for submission and consideration of proposed installment agreements.
(c) Acceptance, form, and terms of installment agreements.
(d) Rejection of a proposed installment agreement.
(e) Modification or termination of installment agreements by the Internal Revenue Service.
(f) Effect of installment agreement or pending installment agreement on collection activity.
(g) Suspension of the statute of limitations on collection.
(h) Annual statement.
(i) Biannual review of partial payment installment agreements.
(j) Cross reference.
(k) Effective date.

Par. 3. Section 301.6159–1 is revised to read as follows:

§301.6159–1 Agreements for payment of tax liabilities in installments.

(a) Authority. The Commissioner may enter into a written agreement with a taxpayer that allows the taxpayer to make scheduled periodic payments of any tax liability if the Commissioner determines that such agreement will facilitate full or partial collection of the tax liability.

(b) Procedures for submission and consideration of proposed installment agreements—(1) In general. A proposed installment agreement must be submitted according to the procedures, and in the form and manner, prescribed by the Commissioner.

(2) When a proposed installment agreement becomes pending. A proposed installment agreement becomes pending when it is accepted for processing. The Internal Revenue Service (IRS) may not accept a proposed installment agreement for processing following reference of a case involving the liability that is the subject of the proposed installment agreement to the Department of Justice for prosecution or defense. The proposed installment agreement remains pending until the IRS accepts the proposal, the IRS notifies the taxpayer that the proposal has been rejected, or the proposal is withdrawn by the taxpayer. If a proposed installment agreement that has been accepted for processing does not contain sufficient information to permit the IRS to evaluate whether the proposal should be accepted, the IRS will request the taxpayer to provide the needed additional information. If the taxpayer does not submit the additional information that the IRS has requested within a reasonable time period after such a request, the IRS may reject the proposed installment agreement.

(3) Revised proposals of installment agreements submitted following rejection. If, following the rejection of a proposed installment agreement, the IRS determines that the taxpayer made a good faith reversion of the proposal and submitted the revision within 30 days of the date of rejection, the provisions of this section shall apply to that revised proposal. If, however, the IRS determines that a revision was not made in good faith, the provisions of this section do not apply to the revision and the appeal period in paragraph (d)(3) of this section continues to run from the date of the original rejection.

(c) Acceptance, form, and terms of installment agreements—(1) Acceptance of an installment agreement—(i) In general. A proposed installment agreement has not been accepted until the IRS notifies the taxpayer or the taxpayer’s representative of its acceptance. Except as provided in paragraph (c)(1)(iii) of this section, the Commissioner has the discretion to accept or reject any proposed installment agreement.

(ii) Acceptance does not reduce liabilities. The acceptance of an installment agreement by the IRS does not reduce the amount of taxes, interest, or penalties owed. (However, penalties may continue to accrue at a reduced rate pursuant to section 6651(h).)

(iii) Guaranteed installment agreements. In the case of a liability of an individual for income tax, the Commissioner shall accept a proposed installment agreement if, as of the date the individual proposes the installment agreement—

(A) The aggregate amount of the liability (not including interest, penalties, additions to tax, and additional amounts) does not exceed $10,000;

(B) The taxpayer (and, if the liability relates to a joint return, the taxpayer’s spouse) has not, during any of the preceding five taxable years—

(1) Failed to file any income tax return;

(2) Failed to pay any required income tax; or

(3) Entered into an installment agreement for the payment of any income tax;

(C) The Commissioner determines that the taxpayer is financially unable to pay the liability in full when due (and the taxpayer submits any information the Commissioner requires to make that determination);

(D) The installment agreement requires full payment of the liability within three years; and

(E) The taxpayer agrees to comply with the provisions of the Internal Revenue Code for the period the agreement is in effect.

(2) Form of installment agreements. An installment agreement must be in writing. A written installment agreement may take the form of a document signed by the taxpayer and the Commissioner or a written confirmation of an agreement entered into by the taxpayer and the Commissioner that is mailed or personally delivered to the taxpayer.

(3) Terms of installment agreements. (i) Except as otherwise provided in this section, an installment agreement is effective from the date the IRS notifies the taxpayer or the taxpayer’s representative of its acceptance until the date the agreement ends by its terms or until it is superseded by a new installment agreement.

(ii) By its terms, an installment agreement may end upon the expiration of the period of limitations on collection in section 6502 and §301.6502–1, or at some prior date.

(iii) As a condition to entering into an installment agreement with a taxpayer, the Commissioner may require that—

(A) The taxpayer agree to a reasonable extension of the period of limitations on collection; and

(B) The agreement contain terms that protect the interests of the Government.

(iv) Except as otherwise provided in an installment agreement, all payments made under the installment agreement will be applied in the best interests of the Government.

(v) While an installment agreement is in effect, the Commissioner may request,
and the taxpayer must provide, a financial condition update at any time.

(vi) At any time after entering into an installment agreement, the Commissioner and the taxpayer may agree to modify or terminate an installment agreement or may agree to a new installment agreement that supercedes the existing agreement.

(d) Rejection of a proposed installment agreement—(1) When a proposed installment agreement becomes rejected. A proposed installment agreement has not been rejected until the IRS notifies the taxpayer or the taxpayer’s representative of the rejection, the reason(s) for rejection, and the right to an appeal.

(2) Independent administrative review. The IRS may not notify a taxpayer or taxpayer’s representative of the rejection of an installment agreement until an independent administrative review of the proposed rejection is completed.

(3) Appeal of rejection of a proposed installment agreement. The taxpayer may administratively appeal a rejection of a proposed installment agreement to the IRS Office of Appeals (Appeals) if, within the 30-day period commencing the day after the taxpayer is notified of the rejection, the taxpayer requests an appeal in the manner provided by the Commissioner.

(e) Modification or termination of installment agreements by the Internal Revenue Service—(1) Inadequate information or jeopardy. The Commissioner may terminate an installment agreement if the Commissioner determines that—

(i) Information which was provided to the IRS by the taxpayer or the taxpayer’s representative in connection with the granting of the installment agreement was inaccurate or incomplete in any material respect; or

(ii) Collection of any liability to which the installment agreement applies is in jeopardy.

(2) Change in financial condition, failure to timely pay an installment or other Federal tax liability, or failure to provide requested financial information. The Commissioner may modify or terminate an installment agreement if—

(i) The Commissioner determines that the financial condition of a taxpayer that is party to the agreement has significantly changed; or

(ii) A taxpayer that is party to the installment agreement fails to—

(A) Timely pay an installment in accordance with the terms of the installment agreement;

(B) Pay any other Federal tax liability when the liability becomes due; or

(C) Provide a financial condition update requested by the Commissioner.

(3) Notice. Unless the Commissioner determines that collection of the tax is in jeopardy, the Commissioner will notify the taxpayer in writing at least 30 days prior to modifying or terminating an installment agreement pursuant to paragraph (e)(1) or (2) of this section. The notice provided pursuant to this section must briefly describe the reason for the intended modification or termination. Upon receiving notice, the taxpayer may provide information showing that the reason for the proposed modification or termination is incorrect.

(4) Appeal of modification or termination of an installment agreement. The taxpayer may administratively appeal the modification or termination of an installment agreement to Appeals if, following issuance of the notice required by paragraph (e)(3) of this section and prior to the expiration of the 30-day period commencing the day after the modification or termination is to take effect, the taxpayer requests an appeal in the manner provided by the Commissioner.

(f) Effect of installment agreement or pending installment agreement on collection activity—(1) In general. No levy may be made to collect a tax liability that is the subject of an installment agreement during the period that a proposed installment agreement is pending with the IRS, for 30 days immediately following the rejection of a proposed installment agreement, during the period that an installment agreement is in effect, and for 30 days immediately following the termination of an installment agreement. If, prior to the expiration of the 30-day period following the rejection or termination of an installment agreement, the taxpayer appeals the rejection or termination decision, no levy may be made while the rejection or termination is being considered by Appeals. This section will not prohibit levy to collect the liability of any person other than the person or persons named in the installment agreement.

(2) Exceptions. Paragraph (f)(1) of this section shall not prohibit levy if the taxpayer files a written notice with the IRS that waives the restriction on levy imposed by this section, the IRS determines that the proposed installment agreement was submitted solely to delay collection, or the IRS determines that collection of the tax to which the installment agreement or proposed installment agreement relates is in jeopardy.

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

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

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

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

(ii) Proceedings in court. Except as otherwise provided in this paragraph (f)(3)(ii), the IRS will not refer a case to the Department of Justice for the commencement of a proceeding in court, against a person named in an installment agreement or proposed installment agreement, if levy to collect the liability is prohibited by paragraph (f)(1) of this section. Without regard to whether a person is named in an installment agreement or proposed installment agreement, however, the IRS may authorize the Department of Justice to file a counterclaim or third-party complaint in a refund action or to join that person in any other proceeding in which liability for the tax that is the subject of the installment agreement or proposed installment agreement may be established or disputed, including a suit against the United States under 28 U.S.C. 2410. In addition, the United States may file a claim in any bankruptcy proceeding or insolvency action brought by or against such person. If a person named in an installment agreement is joined in a proceeding, the United States obtains a judgment against that person, and the case is referred back to the IRS for collection, collection will continue to occur pursuant to the terms of the installment agreement. Notwithstanding the installment agreement, any claim or
suit permitted will be for the full amount of the liabilities owed.

(g) Suspension of the statute of limitations on collection. The statute of limitations under section 6502 for collection of any liability shall be suspended during the period that a proposed installment agreement relating to that liability is pending with the IRS, for 30 days immediately following the rejection of a proposed installment agreement, and for 30 days immediately following the termination of an installment agreement. If, within the 30 days following the rejection or termination of an installment agreement, the taxpayer files an appeal with Appeals, the statute of limitations for collection shall be suspended while the rejection or termination is being considered by Appeals. The statute of limitations for collection shall continue to run if an exception under paragraph (f)(2) of this section applies and levy is not prohibited with respect to the taxpayer.

(h) Annual statement. The Commissioner shall provide each taxpayer who is party to an installment agreement under this section with an annual statement setting forth the initial balance owed at the beginning of the year, the payments made during the year, and the remaining balance as of the end of the year.

(i) Biannual review of partial payment installment agreements. The Commissioner shall perform a review of the taxpayer’s financial condition in the case of a partial payment installment agreement at least once every two years. The purpose of this review is to determine whether the taxpayer's financial condition has significantly changed so as to warrant an increase in the value of the payments being made or termination of the agreement.

(j) Cross reference. Pursuant to section 6601(b)(1), the last day prescribed for payment is determined without regard to any installment agreement, including for purposes of computing penalties and interest provided by the Internal Revenue Code. For special rules regarding the computation of the failure to pay penalty while certain installment agreements are in effect, see section 6651(h) and §301.6651–1(a)(4).

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

Par. 4. Section 301.6331–4 is revised to read as follows:

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

Cross-reference. For provisions relating to the making of levies while an installment agreement is pending or in effect, see §301.6159–1.

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

(Filed by the Office of the Federal Register on March 2, 2007, 8:45 a.m., and published in the issue of the Federal Register for March 5, 2007, 72 F.R. 9712)

Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulation

Section 181 — Deduction for Qualified Film and Television Production Costs

REG–115403–05

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing temporary regulations (T.D. 9312) under section 181 of the Internal Revenue Code relating to deductions for costs of producing qualified film and television productions. These temporary regulations reflect changes to the law made by the American Jobs Creation Act of 2004 and the Gulf Opportunity Zone Act of 2005, and affect taxpayers that produce films and television productions within the United States. This action is necessary to provide guidance for the application of section 181. The text of the temporary regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments and requests for a public hearing must be received by May 10, 2007.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG–115403–05), room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG–115403–05), Courier’s Desk, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at http://www.Regulations.gov/ (IRS REG–115403–05).

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Bernard P. Harvey, (202) 622–3110; concerning submissions and to request a hearing, Kelly Banks, (202) 622–7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in this notice of proposed rulemaking have been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collections of information should be sent to the Office of Management and Budget, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the Internal Revenue Service, Attn: IRS Reports Clearance Officer, SE:W:CAR:MP:T:T:SP, Washington, DC 20224. Comments on the collection of information should be received by April 10, 2007. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information;

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques.
or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of service to provide information.

The collection of information in this proposed regulation is in §1.181–2T(c). This information is required to verify that the production cost of the film or television production for which the deduction under section 181 of the Internal Revenue Code is claimed does not exceed the statutory production cost limit, that at least 75 percent of the compensation from the production is compensation for services performed in the United States, that production costs deducted under section 181(a)(2)(B) are substantially incurred in the specific areas designated in section 181(a)(2)(B), and that, in situations in which more than one taxpayer is claiming a deduction for a single production, the total deduction for the production does not exceed the statutory limit. The collection of information is mandatory. The likely recordkeepers are business or other for-profit institutions, and small businesses or organizations.

Estimated total annual recordkeeping burden: 1,500 hours.

The estimated annual burden per recordkeeper varies from 2 to 4 hours, depending on individual circumstances, with an estimated average of 3 hours.

Estimated number of recordkeepers: 500.

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

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

Background


Explanation of Provisions

The temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) to add regulations under section 181 of the Internal Revenue Code of 1986 (Code). The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains these proposed regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) and (d) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that this regulation will not have a significant economic impact on a substantial number of small entities. The proposed regulations impose a collection of information on small entities in order to demonstrate eligibility for tax benefits under the statute, and this collection of information will require recordkeeping. This collection of information is discussed elsewhere in this preamble. However, the recordkeeping required by this collection of information does not differ significantly from the recordkeeping that a taxpayer must perform in order to determine whether the taxpayer is eligible to claim a deduction under the statute. Consequently, the economic impact on small entities resulting from the recordkeeping required under this regulation is de minimis. Accordingly, a regulatory flexibility analysis is not required. We request comment on the accuracy of this certification. Pursuant to section 7805(f) of the Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Bernard P. Harvey, Office of Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART I—INCOME TAXES

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

Authority: 26 U.S.C. 7805 * * *
Par. 2. Sections 1.181–0 through 1.181–6 are added as follows:

§1.181–0 Table of contents.

[The text of this proposed section is the same as the text of §1.181–0T published elsewhere in this issue of the Bulletin.]

§1.181–1 Deduction for qualified film and television production costs.

[The text of this proposed section is the same as the text of §1.181–1T published elsewhere in this issue of the Bulletin.]
Announcement and Report Concerning Advance Pricing Agreements

Announcement 2007–31

February 26, 2007

This Announcement is issued pursuant to § 521(b) of Pub. L. 106–170, the Ticket to Work and Work Incentives Improvement Act of 1999, which requires the Secretary of the Treasury to report annually to the public concerning Advance Pricing Agreements (APAs) and the APA Program. The first report covered calendar years 1991 through 1999. Subsequent reports covered separately each calendar year 2000 through 2005. This eighth report describes the experience, structure and activities of the APA Program during calendar year 2006. It does not provide guidance regarding the application of the arm’s length standard.

Matthew W. Frank
Director, Advance Pricing Agreement Program

Background

Internal Revenue Code (IRC) § 482 provides that the Secretary may distribute, apportion, or allocate gross income, deductions, credits, or allowances between or among two or more commonly controlled businesses if necessary to reflect clearly the income of such businesses. Under the § 482 regulations, the standard to be applied in determining the true taxable income of a controlled business is that of a business dealing at arm’s length with an unrelated business. The arm’s length standard has also been adopted by the international community and is incorporated into the transfer pricing guidelines issued by the Organization for Economic Cooperation and Development (OECD). OECD, TRANSFER PRICING GUIDELINES FOR MULTINATIONAL ENTERPRISES AND TAX ADMINISTRATORS (1995). Transfer pricing issues by their nature are highly factual and have traditionally been one of the largest issues identified by the IRS in its audits of multinational corporations. The APA Program is designed to resolve actual or potential transfer pricing disputes in a principled, cooperative manner, as an alternative to the traditional examination process. An APA is a binding contract between the IRS and a taxpayer by which the IRS agrees not to seek a transfer pricing adjustment under IRC § 482 for a covered transaction if the taxpayer files its tax return for a covered year consistent with the agreed transfer pricing method (TPM). In 2006, the IRS and taxpayers executed 82 APAs and amended three APAs.


Advance Pricing Agreements

An APA generally combines an agreement between a taxpayer and the IRS on an appropriate TPM for the transactions at issue (Covered Transactions) with an agreement between the U.S. and one or more foreign tax authorities (under the authority of the mutual agreement process of our income tax treaties) that the TPM is correct. With such a “bilateral” APA, the taxpayer ordinarily is assured that the income associated with the Covered Transactions will not be subject to double taxation by the U.S. and the foreign jurisdiction. It is the policy of the United States, as reflected in §§ 2.08 and 7 of Rev. Proc. 2006–9, to encourage taxpayers that enter the APA Program to seek bilateral or multilateral APAs when competent authority procedures are available with respect to the foreign country or countries involved. However, the IRS may execute an APA with a taxpayer without reaching a competent authority agreement (a “unilateral” APA).

A unilateral APA is an agreement between a taxpayer and the IRS establishing an approved TPM for U.S. tax purposes. A unilateral APA binds the taxpayer and the IRS, but does not prevent foreign tax administrations from taking different positions on the appropriate TPM for a transaction. As stated in § 7.07 of Rev. Proc. 2006–9, should a transaction covered by a unilateral APA be subject to double taxation as the result of an adjustment by a foreign tax administration, the taxpayer may seek relief by requesting that the U.S. Competent Authority consider initiating a mutual agreement proceeding pursuant to an applicable income tax treaty (if any).

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

The APA Program

An IRS team headed by an APA team leader is responsible for the consideration of each APA. As of December 31, 2006, the APA Program had 20 team leaders. The team leader is responsible for organizing the IRS APA team. The IRS APA team leader arranges meetings with the taxpayer, secures whatever information is necessary from the taxpayer to analyze the taxpayer’s related party transactions and the available facts under the arm’s length standard of IRC § 482 and the regulations thereunder, and leads the discussions with the taxpayer.

The APA team generally includes an economist, an international examiner, LMSB field counsel, and, in a bilateral case, a U.S. Competent Authority analyst who leads the discussions with the treaty partner. The economist may be from the APA Program or the IRS field organization. As of December 31, 2006, the APA Program had eight economists. The APA team may also include an LMSB International Technical Advisor, other LMSB exam personnel, and an Appeals Officer.

The APA Process

The APA process is voluntary. Taxpayers submit an application for an APA, together with a user fee as set forth in Rev. Proc. 2006–9, § 4.12. The APA process can be broken into five phases: (1) application; (2) due diligence; (3) analysis; (4) discussion and agreement; and (5) drafting, review, and execution.

(1) Application

In many APA cases, the taxpayer’s application is preceded by a pre-file conference with the APA staff in which the taxpayer can solicit the informal views of the APA Program. Pre-file conferences can occur on an anonymous basis, although a taxpayer must disclose its identity when it applies for an APA. Taxpayers must file the appropriate user fee on or before the due date, including extensions, of the tax return for the first taxable year that the taxpayer proposes to be covered by the APA. (If the taxpayer receives an extension to file its tax return, it must file its user fee no later than the actual filing date of the return.) Many taxpayers file a user fee first and then follow up with a full application later. The procedures for pre-file conferences, user fees, and applications can be found in §§ 3 and 4 of Rev. Proc. 2006–9.

The APA application can be a relatively modest document for small businesses. Section 9 of Rev. Proc. 2006–9 describes the special APA procedures for small business taxpayers. For most taxpayers, however, the APA application is a substantial document filling several binders.
The application is assigned to an APA team leader who is responsible for the case. The APA team leader’s first responsibility is to organize the APA team. This involves contacting the appropriate LMSB International Territory Manager to secure the assignment of an international examiner to the APA case and the LMSB Counsel’s office to secure a field counsel lawyer. In a bilateral case, the U.S. Competent Authority will assign a U.S. Competent Authority analyst to the team. In a large APA case, the international examiner may invite his or her manager and other LMSB personnel familiar with the taxpayer to join the team. If the APA may affect taxable years in Appeals, the appropriate appellate conferee will be invited to join the team. In appropriate cases, the APA team leader contacts the Manager, LMSB International Technical Advisors, to determine whether to include a technical advisor on the team. The IRS APA team will generally include a technical advisor if the APA request concerns cost sharing, or a complex intangibles or services transaction. The APA team leader then distributes copies of the APA application to all team members and sets up an opening conference with the taxpayer. The APA office strives to hold this opening conference within 45 days of the assignment of the case to a team leader. At the opening conference, the APA team leader proposes a case plan designed, if feasible, to complete a unilateral APA or, in the case of a bilateral APA, the recommended U.S. negotiating position within 12 months from the date the full application is filed. The actual median and average times for completing unilateral APAs, recommended negotiating positions for bilateral APAs, and APAs for small business taxpayers are shown below in Tables 2, 5, and 11, respectively.

(2) Due Diligence

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

(3) Analysis

A significant part of the analytical work associated with an APA is done typically by the APA economist and/or an IRS field economist assigned to the case. The analysis may result in the need for additional information. Once the IRS APA team has completed its due diligence and analysis, it begins discussions with the taxpayer over the various aspects of the APA including the covered transactions, the TPM, the selection of comparable transactions, asset intensity and other adjustments, the appropriate critical assumptions, the APA term, and other key issues. The APA team leader will discuss particularly difficult issues with his or her managers, but generally the APA team leader is empowered to negotiate the APA.

(4) Discussion and Agreement

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

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

Once the APA Program completes the recommended U.S. negotiating position, the APA process shifts from the APA Program to the U.S. Competent Authority. The U.S. Competent Authority analyst assigned to the APA takes the recommended U.S. negotiating position and prepares the final U.S. negotiating position, which is then transmitted to the foreign competent authority. The negotiations with the foreign competent authority are conducted by the U.S. Competent Authority analyst, most often in face-to-face negotiating sessions conducted periodically throughout the year. At the request of the U.S. Competent Authority analyst, the APA team leader may continue to assist the negotiations.
In unilateral APA cases, the discussions proceed solely between the APA Program and the taxpayer. In a unilateral case, the taxpayer and the APA Program must reach agreement to conclude an APA. As in bilateral cases, the APA team leader almost always will achieve a consensus with the IRS field personnel assigned to the APA team regarding the final APA. The APA Program has a procedure in which the IRS field personnel are solicited formally for their concurrence in the final APA. This concurrence, or any item in disagreement, is noted in a memorandum prepared by the APA team leader that accompanies the final APA sent forward for review and execution.

(5) Drafting, Review, and Execution

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

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

Attachment A contains the current version of the model APA language.

The Current APA Office Structure, Composition, and Operation

In 2006, the APA office consisted of four branches with Branches 1 and 3 staffed with APA team leaders and Branch 2 staffed with economists. Branch 4, the APA West Coast branch, is headquartered in Laguna Niguel, California, with an additional office in San Francisco, and is staffed with both team leaders and economists.

Overall, the APA staff increased by seven, to 40 from 33, from the end of 2005 to the end of 2006. Three team leaders, three economists, and a branch chief were added to the Program.

As of December 31, 2006, the APA staff was as follows:

The staffing increase in 2006 was achieved through the hiring of eight persons and the addition of a second person detailed to the APA Program from the IRS Appeals Office. This hiring, most of which occurred mid-year, allowed the APA Program to realize a 6 percent increase in staffing in 2006 over 2005 measured by total work hours and a 12 percent increase in staffing for the second half of 2006 over the same period in 2005, again measured by total work hours. The change in APA staffing levels over the last six years is reflected in the table below.
APA Issue/Industry Coordination Teams

In May 2005, the IRS Chief Counsel announced a series of initiatives to improve APA Program performance. One initiative was to increase specialization within the office by creating teams of select individuals to handle all cases of a particular type. The purpose was to increase efficiency, quality, and consistency.

The APA Program selected five categories of cases for specialization – cases involving cost sharing arrangements, financial products, the semiconductor industry, the automotive industry, and the pharmaceutical industry. These categories were selected because they each had a sufficient number of cases and commonality of issues to warrant their assignment to teams. Cases falling within these five categories have historically accounted for about 40 percent of the APA Program’s case load (excluding Small Business Taxpayer (“SBT”) cases) and more than half of its total case time. At the end of 2006, cases within these five categories account for 31 of the 90 non-SBT cases pending in the office that were either unilateral APAs or bilateral APAs that had not yet been forwarded to Competent Authority.
Staffing of the coordination teams at the end of 2006 is indicated below.

<table>
<thead>
<tr>
<th>Auto &amp; Auto Parts</th>
<th>Pharmaceuticals &amp; Medical Devices</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Craig Sharon, Reviewer</strong></td>
<td><strong>Craig Sharon, Reviewer</strong></td>
</tr>
<tr>
<td>Tom Herring, Team Leader</td>
<td>Clark Armitage, Team Leader</td>
</tr>
<tr>
<td>Per Juvkam-Wold, Team Leader</td>
<td>Tom Herring, Team Leader</td>
</tr>
<tr>
<td>Vijay Rajan, Team Leader</td>
<td>Peter Rock, Team Leader</td>
</tr>
<tr>
<td>Victor Thayer, Team Leader</td>
<td>Victor Thayer, Team Leader</td>
</tr>
<tr>
<td>Walt Bottiny, Principal Economist</td>
<td>Stephen Meadows, Principal Economist</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cost Sharing</th>
<th>Financial Products</th>
<th>Semiconductors</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Patricia McCarroll, Reviewer</strong></td>
<td><strong>Richard Osborne, Reviewer</strong></td>
<td><strong>Greg Ossi, Reviewer</strong></td>
</tr>
<tr>
<td>David Chamberlain, Team Leader</td>
<td>Clark Armitage, Team Leader</td>
<td>April Adams-Johnson, Team Leader</td>
</tr>
<tr>
<td>Matthew Kramer, Team Leader</td>
<td>Per Juvkam-Wold, Team Leader</td>
<td>Matthew Kramer, Team Leader</td>
</tr>
<tr>
<td>Craig Sharon, Team Leader</td>
<td>Donna McComber, Principal Economist</td>
<td>Vijay Rajan, Team Leader</td>
</tr>
<tr>
<td>Robert Weissler, Team Leader</td>
<td></td>
<td>Peter Rock, Team Leader</td>
</tr>
<tr>
<td>Mark Bronson, Principal Economist</td>
<td></td>
<td>Behzad Touhidi-Baghini, Principal Economist</td>
</tr>
</tbody>
</table>

The APA Program is mindful that the purpose of the coordination effort is not to impose the same transfer pricing method on all taxpayers in an industry. The appropriate transfer pricing method remains a case-by-case determination, influenced by numerous factors that are not common to all companies operating in a particular industry. While the coordination effort may result in the APA Program promoting a common approach on some issues where appropriate, the Program expects that the greater industry familiarity developed through the coordination effort will also allow it to develop a more sophisticated understanding of issues that will permit more tailored approaches, thereby promoting more (appropriately) varied results than might otherwise be the case.

**APA Training**

In 2006, the APA office continued its training activities. Training sessions addressed APA-related current developments, new APA office practices and procedures, and international tax law issues. The training materials used for new hires are available to the public through the APA internet site at [http://www.irs.gov/businesses/corporations/article/0,,id=96221,00.html](http://www.irs.gov/businesses/corporations/article/0,,id=96221,00.html). These materials do not constitute guidance on the application of the arm’s length standard and are not to be relied upon or cited as precedent.

**APA Program Statistical Data**

[§ 521(b)(2)(C) and (E)]

The statistical information required under § 521(b)(2)(C) is contained in Tables 1 and 10 below; the information required under § 521(b)(2)(E) is contained in Tables 2 and 3 below:
### TABLE 1: APA APPLICATIONS, EXECUTED APAs, AND PENDING APAs

<table>
<thead>
<tr>
<th></th>
<th>Unilateral</th>
<th>Bilateral</th>
<th>Multilateral</th>
<th>Year Total</th>
<th>Cumulative Total</th>
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</thead>
<tbody>
<tr>
<td>APA applications filed during year 2006</td>
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<td>67</td>
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<td>109</td>
<td>1037</td>
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<tr>
<td>All APAs executed</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Year 2006</td>
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<td>39</td>
<td>1</td>
<td>82</td>
<td>692</td>
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<tr>
<td>1991–2005</td>
<td>282</td>
<td>320</td>
<td>8</td>
<td>610</td>
<td></td>
</tr>
<tr>
<td>APA renewals executed during year 2006</td>
<td>21</td>
<td>14</td>
<td></td>
<td>35</td>
<td>180</td>
</tr>
<tr>
<td>Revised or Amended APAs executed during year 2006</td>
<td>2</td>
<td>1</td>
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<td>Pending requests for APAs</td>
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<td>203</td>
<td></td>
<td>249</td>
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<tr>
<td>Pending requests for new APAs</td>
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<td>137</td>
<td></td>
<td>167</td>
<td></td>
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<tr>
<td>Pending requests for renewal APAs</td>
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<td>66</td>
<td></td>
<td>82</td>
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<tr>
<td>APAs canceled or revoked</td>
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<td>0</td>
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<td>0</td>
<td>5</td>
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<tr>
<td>APAs withdrawn</td>
<td>3</td>
<td>13</td>
<td></td>
<td>16</td>
<td>121</td>
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### TABLE 2: MONTHS TO COMPLETE APAs

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<tr>
<th>Months to Complete Advance Pricing Agreements in Year 2006</th>
<th>All New</th>
<th>All Renewals</th>
<th>All Combined</th>
</tr>
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<tbody>
<tr>
<td>Average</td>
<td>33.9</td>
<td>27.5</td>
<td>31.2</td>
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<tr>
<td>Median</td>
<td>35.3</td>
<td>25.9</td>
<td>28.1</td>
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<table>
<thead>
<tr>
<th>Unilateral New</th>
<th></th>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Average</td>
<td>22.0</td>
<td>18.5</td>
<td>20.3</td>
</tr>
<tr>
<td>Median</td>
<td>22.9</td>
<td>17.4</td>
<td>18.7</td>
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<table>
<thead>
<tr>
<th>Unilateral Renewals</th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>22.0</td>
<td>18.5</td>
<td>20.3</td>
</tr>
<tr>
<td>Median</td>
<td>22.9</td>
<td>17.4</td>
<td>18.7</td>
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<table>
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<tr>
<th>Unilateral Combined</th>
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<tr>
<td>Average</td>
<td>22.0</td>
<td>18.5</td>
<td>20.3</td>
</tr>
<tr>
<td>Median</td>
<td>22.9</td>
<td>17.4</td>
<td>18.7</td>
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<table>
<thead>
<tr>
<th>Bilateral/Multilateral New</th>
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<tr>
<td>Average</td>
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<td>40.9</td>
<td>42.7</td>
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<tr>
<td>Median</td>
<td>45.4</td>
<td>38.5</td>
<td>43.7</td>
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<thead>
<tr>
<th>Bilateral/Multilateral Renewals</th>
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<tr>
<td>Average</td>
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<td>40.9</td>
<td>42.7</td>
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<tr>
<td>Median</td>
<td>45.4</td>
<td>38.5</td>
<td>43.7</td>
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TABLE 3: APA COMPLETION TIME – MONTHS PER APA

<table>
<thead>
<tr>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
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<td>51</td>
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<td>68</td>
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</tr>
</tbody>
</table>

TABLE 4: RECOMMENDED NEGOTIATING POSITIONS

Recommended Negotiating Positions Completed in Year 2006 | 62

TABLE 5: MONTHS TO COMPLETE RECOMMENDED NEGOTIATING POSITIONS

<table>
<thead>
<tr>
<th></th>
<th>New</th>
<th>Renewal</th>
<th>Combined</th>
</tr>
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<tbody>
<tr>
<td>Average</td>
<td>26.1</td>
<td>26.5</td>
<td>26.2</td>
</tr>
<tr>
<td>Median</td>
<td>23.9</td>
<td>28.9</td>
<td>23.9</td>
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</table>
### TABLE 6: RECOMMENDED NEGOTIATING POSITIONS COMPLETION TIME – MONTHS PER APA

<table>
<thead>
<tr>
<th>Months</th>
<th>Number</th>
<th>Months</th>
<th>Number</th>
<th>Months</th>
<th>Number</th>
<th>Months</th>
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<tbody>
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<td>18</td>
<td>3</td>
<td>34</td>
<td>3</td>
<td>50</td>
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<td></td>
</tr>
<tr>
<td>3</td>
<td>19</td>
<td></td>
<td>35</td>
<td>51</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
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<td>36</td>
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<td>52</td>
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<td></td>
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<tr>
<td>5</td>
<td>1</td>
<td>21</td>
<td>3</td>
<td>37</td>
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<td>53</td>
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<tr>
<td>6</td>
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<td>8</td>
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<td>24</td>
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<td>9</td>
<td>25</td>
<td>1</td>
<td>41</td>
<td>1</td>
<td>57</td>
<td></td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>26</td>
<td>1</td>
<td>42</td>
<td></td>
<td>58</td>
<td>1</td>
<td></td>
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<tr>
<td>11</td>
<td>2</td>
<td>27</td>
<td>1</td>
<td>43</td>
<td>59</td>
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</tr>
<tr>
<td>12</td>
<td>28</td>
<td>4</td>
<td>44</td>
<td>2</td>
<td>60</td>
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<td></td>
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<tr>
<td>13</td>
<td>29</td>
<td>2</td>
<td>45</td>
<td></td>
<td>61</td>
<td></td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>30</td>
<td>3</td>
<td>46</td>
<td></td>
<td>62</td>
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<tr>
<td>15</td>
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<td>31</td>
<td>2</td>
<td>47</td>
<td>63</td>
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</tr>
<tr>
<td>16</td>
<td>32</td>
<td>2</td>
<td>48</td>
<td>64</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Tables 7 and 8 below show how long each APA request pending at the end of 2006 has been in the system as measured from the filing date of the APA submission. The numbers for pending unilateral and bilateral cases differ from the numbers in Table 1 because Tables 7 and 8 reflect only cases for which submissions have been received while Table 1 includes any case for which a user fee has been paid.

### TABLE 7: UNILATERAL APAs – TIME IN INVENTORY – MONTHS PER APA

<table>
<thead>
<tr>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
<th>Number of APAs</th>
<th>Months</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>2</td>
<td>8</td>
<td>4</td>
<td>15</td>
<td>1</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>9</td>
<td></td>
<td>16</td>
<td>1</td>
<td>23</td>
<td>2</td>
</tr>
<tr>
<td>3</td>
<td>10</td>
<td></td>
<td>17</td>
<td></td>
<td></td>
<td>24</td>
<td>1</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
<td>11</td>
<td>5</td>
<td>18</td>
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<tr>
<td>5</td>
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<td>12</td>
<td>1</td>
<td>19</td>
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<tr>
<td>6</td>
<td>2</td>
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<td>20</td>
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<td>27</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>11</td>
<td>14</td>
<td>21</td>
<td>1</td>
<td>28</td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>
Of the 218 cases in the APA Program’s inventory shown in Tables 7 and 8, 108 cases (all of which are reflected in Table 8) are bilateral cases that have been forwarded to the Competent Authority office for discussion with a treaty partner. This leaves 110 cases in the APA Program’s active inventory at the end of 2006 that are either unilateral APAs (35 cases) or bilateral APAs for which the APA Program has not yet completed a recommended negotiating position (75 cases).

The table below shows the average age (in months) of the 110 active cases in inventory at the end of 2006, along with a comparison of the number of active cases and their average age at year-end for each year back to 2002. The table also shows the same information for cases that were at least 6 months old or 1 year old (the latter being a subset of the former) at the end of each year to allow comparison without potential distortions caused by year-to-year variations in the number of cases received in the latter half or during the course of the year.

![Table 8: Bilateral APAs – Time in Inventory – Months per APA](image-url)

Of the 218 cases in the APA Program’s inventory shown in Tables 7 and 8, 108 cases (all of which are reflected in Table 8) are bilateral cases that have been forwarded to the Competent Authority office for discussion with a treaty partner. This leaves 110 cases in the APA Program’s active inventory at the end of 2006 that are either unilateral APAs (35 cases) or bilateral APAs for which the APA Program has not yet completed a recommended negotiating position (75 cases).

The table below shows the average age (in months) of the 110 active cases in inventory at the end of 2006, along with a comparison of the number of active cases and their average age at year-end for each year back to 2002. The table also shows the same information for cases that were at least 6 months old or 1 year old (the latter being a subset of the former) at the end of each year to allow comparison without potential distortions caused by year-to-year variations in the number of cases received in the latter half or during the course of the year.
### TABLE 9: NUMBER AND AVERAGE AGE OF ACTIVE CASES IN INVENTORY AT YEAR-END

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active cases</td>
<td>80</td>
<td>106</td>
<td>130</td>
<td>133</td>
<td>110</td>
</tr>
<tr>
<td>Average age (months)</td>
<td>14.1</td>
<td>15.1</td>
<td>15.2</td>
<td>13.2</td>
<td>10.6</td>
</tr>
<tr>
<td>Active cases 6+ months</td>
<td>40</td>
<td>78</td>
<td>106</td>
<td>87</td>
<td>81</td>
</tr>
<tr>
<td>Average age (months)</td>
<td>25.5</td>
<td>19.4</td>
<td>17.8</td>
<td>18.5</td>
<td>13.0</td>
</tr>
<tr>
<td>Active cases 1+ year</td>
<td>22</td>
<td>46</td>
<td>60</td>
<td>55</td>
<td>32</td>
</tr>
<tr>
<td>Average age (months)</td>
<td>38.9</td>
<td>26.8</td>
<td>24.2</td>
<td>23.3</td>
<td>19.4</td>
</tr>
</tbody>
</table>

### TABLE 10: SMALL BUSINESS TAXPAYER APAs

<table>
<thead>
<tr>
<th>Small Business Taxpayer APAs Completed in Year 2006</th>
<th>19</th>
</tr>
</thead>
<tbody>
<tr>
<td>New</td>
<td>10</td>
</tr>
<tr>
<td>Renewals</td>
<td>9</td>
</tr>
<tr>
<td>Unilateral</td>
<td>15</td>
</tr>
<tr>
<td>Bilateral</td>
<td>4</td>
</tr>
</tbody>
</table>

### TABLE 11: MONTHS TO COMPLETE SMALL BUSINESS TAXPAYER APAs

<table>
<thead>
<tr>
<th>Months to Complete Small Business Taxpayer APAs in Year 2006</th>
<th>New</th>
<th>Renewal</th>
<th>Combined</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average</td>
<td>24.2</td>
<td>21.4</td>
<td>22.9</td>
</tr>
<tr>
<td>Median</td>
<td>20.9</td>
<td>21.2</td>
<td>21.2</td>
</tr>
</tbody>
</table>

### TABLE 12: INDUSTRIES COVERED

<table>
<thead>
<tr>
<th>Industry Involved – NAICS Codes</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Electronic equipment, appliance and component manufacturing – 335</td>
<td>10–12</td>
</tr>
<tr>
<td>Wholesale trade, durable goods – 421</td>
<td>10–12</td>
</tr>
<tr>
<td>Computer and electronic product manufacturing – 334</td>
<td>7–9</td>
</tr>
<tr>
<td>Chemical manufacturing – 325</td>
<td>4–6</td>
</tr>
<tr>
<td>Information service and data processing services – 514</td>
<td>4–6</td>
</tr>
<tr>
<td>Miscellaneous manufacturing – 339</td>
<td>4–6</td>
</tr>
</tbody>
</table>

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

<table>
<thead>
<tr>
<th>Industry</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Machinery manufacturing</td>
<td>4–6</td>
</tr>
<tr>
<td>Food manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Securities, commodity contracts and other intermediary and related activities</td>
<td>1–3</td>
</tr>
<tr>
<td>Transportation equipment manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Wholesale trade, nondurable goods</td>
<td>1–3</td>
</tr>
<tr>
<td>Motor vehicle and parts dealers</td>
<td>1–3</td>
</tr>
<tr>
<td>Beverage and tobacco manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Fabricated metal manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Sporting goods, hobby, book and music stores</td>
<td>1–3</td>
</tr>
<tr>
<td>Food and beverage stores</td>
<td>1–3</td>
</tr>
<tr>
<td>Air transportation</td>
<td>1–3</td>
</tr>
<tr>
<td>Clothing and clothing accessories stores</td>
<td>1–3</td>
</tr>
<tr>
<td>Broadcasting and telecommunications</td>
<td>1–3</td>
</tr>
<tr>
<td>Plastics and rubber products manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Petroleum and coal manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Wood product manufacturing</td>
<td>1–3</td>
</tr>
<tr>
<td>Water transportation</td>
<td>1–3</td>
</tr>
<tr>
<td>Publishing industries</td>
<td>1–3</td>
</tr>
<tr>
<td>Motion pictures and sound recording industries</td>
<td>1–3</td>
</tr>
</tbody>
</table>

### Trades or Businesses

[$\text{§ 521(b)(2)(D)(i)}$]

The nature of the relationships between the related organizations, trades, or businesses covered by APAs executed in 2006 is set forth in Table 13 below:

**TABLE 13: NATURE OF RELATIONSHIPS BETWEEN RELATED ENTITIES**

<table>
<thead>
<tr>
<th>Relationship</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign Parent – U.S. Subsidiary (-ies)</td>
<td>42</td>
</tr>
<tr>
<td><em>Unilateral</em></td>
<td>21</td>
</tr>
<tr>
<td><em>Bilateral</em></td>
<td>21</td>
</tr>
<tr>
<td>U.S. Parent – Foreign Subsidiary (-ies)</td>
<td>36</td>
</tr>
<tr>
<td><em>Unilateral</em></td>
<td>15</td>
</tr>
<tr>
<td><em>Bilateral</em></td>
<td>21</td>
</tr>
<tr>
<td>Foreign Company and U.S. branch(es)</td>
<td>0</td>
</tr>
<tr>
<td><em>Unilateral</em></td>
<td>0</td>
</tr>
<tr>
<td><em>Bilateral</em></td>
<td>0</td>
</tr>
<tr>
<td>Partnership</td>
<td>4</td>
</tr>
<tr>
<td><em>Unilateral</em></td>
<td>$\leq 3$</td>
</tr>
<tr>
<td><em>Bilateral</em></td>
<td>$\leq 3$</td>
</tr>
</tbody>
</table>

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Relationship — Continued

<table>
<thead>
<tr>
<th>U.S. Company and non-U.S. branch(es)</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unilateral</td>
<td>0</td>
</tr>
<tr>
<td>Bilateral</td>
<td>0</td>
</tr>
</tbody>
</table>

Covered Transactions

[$\text{§ 521(b)(2)(D)(ii)}$]

The controlled transactions covered by APAs executed in 2006 are set forth in Table 14 and Table 15 below:

**TABLE 14: TYPES OF COVERED TRANSACTIONS**

<table>
<thead>
<tr>
<th>Transaction Type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of tangible property into the U.S.</td>
<td>41</td>
</tr>
<tr>
<td>Use of intangible property by Non-U.S. entity</td>
<td>25</td>
</tr>
<tr>
<td>Sale of tangible property from the U.S.</td>
<td>18</td>
</tr>
<tr>
<td>Performance of services by Non-U.S. entity</td>
<td>16</td>
</tr>
<tr>
<td>Use of intangible property by U.S. entity</td>
<td>11</td>
</tr>
<tr>
<td>Performance of services by U.S. entity</td>
<td>11</td>
</tr>
<tr>
<td>R&amp;D cost sharing – U.S. parent</td>
<td>$\leq 3$</td>
</tr>
<tr>
<td>R&amp;D cost sharing – Non-U.S. parent</td>
<td>$\leq 3$</td>
</tr>
<tr>
<td>Financial products – U.S. parent</td>
<td>$\leq 3$</td>
</tr>
<tr>
<td>Other</td>
<td>$\leq 3$</td>
</tr>
</tbody>
</table>

**TABLE 15: TYPES OF SERVICES INCLUDED IN COVERED TRANSACTIONS**

| Intercompany Services Involved in the Covered Transactions | Number |
|*************************************************************|--------|
| Distribution                                              | 24     |
| Technical support services                                 | 20     |
| Marketing                                                 | 19     |
| Logistical support                                        | 19     |
| Administrative                                             | 19     |
| Sales support                                             | 14     |
| Product support                                           | 11     |
| Management                                                | 11     |
| Communication service                                     | 10     |
| Purchasing                                                | 10     |
| Research and development                                  | 7      |
| Accounting                                                | 6      |
| Headquarters costs                                        | 6      |
| Manufacturing services                                    | 6      |
### Intercompany Services Involved in the Covered Transactions — Continued

<table>
<thead>
<tr>
<th>Service</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Legal</td>
<td>4</td>
</tr>
<tr>
<td>Contract research &amp; development</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Warranty services</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Assembly</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Billing services</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Testing and installation services</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

### Business Functions Performed and Risks Assumed

[§ 521(b)(2)(D)(ii)]

The general descriptions of the business functions performed and risks assumed by the organizations, trades, or businesses whose results are tested in the Covered Transactions in the APAs executed in 2006 are set forth in Tables 16 and 17 below:

#### TABLE 16: FUNCTIONS PERFORMED BY THE TESTED PARTY

<table>
<thead>
<tr>
<th>Functions Performed</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Distribution functions</td>
<td>64</td>
</tr>
<tr>
<td>Marketing functions</td>
<td>44</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>41</td>
</tr>
<tr>
<td>Transportation and warehousing</td>
<td>30</td>
</tr>
<tr>
<td>Managerial, legal, accounting, finance, personnel, and other support services</td>
<td>29</td>
</tr>
<tr>
<td>Product assembly and/or packaging</td>
<td>25</td>
</tr>
<tr>
<td>Purchasing and materials management</td>
<td>24</td>
</tr>
<tr>
<td>Research and development</td>
<td>17</td>
</tr>
<tr>
<td>Technical training and tech support for sales staff (including sub-distributors)</td>
<td>17</td>
</tr>
<tr>
<td>Product testing and quality control</td>
<td>17</td>
</tr>
<tr>
<td>Product design and engineering</td>
<td>12</td>
</tr>
<tr>
<td>Licensing of intangibles</td>
<td>11</td>
</tr>
<tr>
<td>Product service (repairs, etc.)</td>
<td>11</td>
</tr>
<tr>
<td>Process engineering</td>
<td>7</td>
</tr>
<tr>
<td>Engineering and construction related services</td>
<td>5</td>
</tr>
<tr>
<td>Consulting services</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Trading and risk management of financial products</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

#### TABLE 17: RISKS ASSUMED BY THE TESTED PARTY

<table>
<thead>
<tr>
<th>Risks Assumed</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risks, including fluctuations in costs, demand, pricing, &amp; inventory</td>
<td>89</td>
</tr>
<tr>
<td>Credit and collection risks</td>
<td>67</td>
</tr>
<tr>
<td>General business risks (e.g., related to ownership of PP&amp;E)</td>
<td>60</td>
</tr>
</tbody>
</table>
Risks Assumed — Continued

<table>
<thead>
<tr>
<th>Risk Type</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial risks, including interest rates &amp; currency</td>
<td>36</td>
</tr>
<tr>
<td>Product liability risks</td>
<td>32</td>
</tr>
<tr>
<td>R&amp;D risks</td>
<td>17</td>
</tr>
</tbody>
</table>

Discussion

The majority of APAs have Covered Transactions that involve numerous business functions and risks. For instance, with respect to functions, companies that manufacture products typically conduct research and development, engage in product design and engineering, manufacture the product, market and distribute the product, and perform support functions such as legal, finance, and human resources services. Regarding risks, companies are subject to market risks, R&D risks, financial risks, credit and collection risks, product liability risks, and general business risks. In the APA evaluation process, a significant amount of time and effort is devoted to understanding how the functions and risks are allocated among the controlled group of companies that are party to the Covered Transactions.

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

The functional analysis is critical in determining the TPM (including the selection of comparables). In evaluating the functional analysis, the APA Program considers contractual terms between the controlled parties and the consistency of the conduct of the parties with respect to the allocation of risk. In accordance with the section 482 regulations, the APA Program also gives consideration to the ability of controlled parties to fund losses that might be expected to occur as a result of the assumption of risk. Another relevant factor considered in evaluating the functional analysis is the extent to which a controlled party exercises managerial or operational control over the business activities that directly influence the amount of income or loss realized. The section 482 regulations posit that parties at arm’s length will ordinarily bear a greater share of those risks over which they have relatively more control.

In addition to the functional analysis, the APA evaluation process considers broader economic factors and conditions including the economic condition of the particular industry.

Related Organizations, Trades, or Businesses Whose Prices or Results are Tested to Determine Compliance with APA Transfer Pricing Methods

[§ 521(b)(2)(D)(iii)]

The related organizations, trades, or businesses whose prices or results are tested to determine compliance with TPMs prescribed in APAs executed in 2006 are set forth in Table 18 below:

<table>
<thead>
<tr>
<th>Type of Organization</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Multiple tested parties</td>
<td>37</td>
</tr>
<tr>
<td>U.S. distributor</td>
<td>31</td>
</tr>
<tr>
<td>U.S. provider of services</td>
<td>14</td>
</tr>
<tr>
<td>U.S. manufacturer</td>
<td>13</td>
</tr>
<tr>
<td>Non-U.S. manufacturer</td>
<td>12</td>
</tr>
<tr>
<td>Non-U.S. distributor</td>
<td>10</td>
</tr>
</tbody>
</table>

2 “Multiple tested parties” includes covered transactions that utilize profit splits, CUPs, and CUTs.
<table>
<thead>
<tr>
<th>Type of Organization — Continued</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Non-U.S. provider of services</td>
<td>5</td>
</tr>
<tr>
<td>Non-U.S. licensee of intangible property</td>
<td>5</td>
</tr>
<tr>
<td>U.S. licensee of intangible property</td>
<td>≤ 3</td>
</tr>
<tr>
<td>U.S. dealer in financial products</td>
<td>≤ 3</td>
</tr>
<tr>
<td>U.S. participant in cost sharing agreement</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

Transfer Pricing Methods and the Circumstances Leading to the Use of Those Methods

[§ 521(b)(2)(D)(iv)]

The TPMs used in APAs executed in 2006 are set forth in Tables 19–20 below:

### TABLE 19: TRANSFER PRICING METHODS USED FOR TRANSFERS OF TANGIBLE AND INTANGIBLE PROPERTY

<table>
<thead>
<tr>
<th>TPM Used</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPM: PLI is operating margin</td>
<td>25</td>
</tr>
<tr>
<td>Residual profit split</td>
<td>20</td>
</tr>
<tr>
<td>CPM: PLI is Berry ratio</td>
<td>11</td>
</tr>
<tr>
<td>CPM: PLI is markup on total costs</td>
<td>10</td>
</tr>
<tr>
<td>Unspecified method</td>
<td>8</td>
</tr>
<tr>
<td>CPM: PLI is gross margin</td>
<td>6</td>
</tr>
<tr>
<td>CUT (intangibles only)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other profit split</td>
<td>≤ 3</td>
</tr>
<tr>
<td>CPM: PLI is other PLI</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Cost Plus Method (tangibles only)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>CUP (tangibles only) – not based on published market data</td>
<td>≤ 3</td>
</tr>
<tr>
<td>CPM: PLI is markup on other costs</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Resale Price Method (tangibles only)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>CPM: PLI is return on assets or capital employed</td>
<td>≤ 3</td>
</tr>
<tr>
<td>CUP (tangibles only) – based on published market data</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

### TABLE 20: TRANSFER PRICING METHODS USED FOR SERVICES

<table>
<thead>
<tr>
<th>TPM Used</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>CPM: PLI is markup on total costs</td>
<td>11</td>
</tr>
<tr>
<td>Cost plus a markup</td>
<td>4</td>
</tr>
<tr>
<td>Cost with no markup</td>
<td>4</td>
</tr>
</tbody>
</table>

---

3 Profit Level Indicators (PLIs) used with the Comparable Profit Method of Treas. Reg. § 1.482–5, and as used in these TPM tables, are as follows: (1) operating margin (ratio of operating profit to sales); (2) Berry ratio (ratio of gross profit to operating expenses); (3) gross margin (ratio of gross profit to sales); (4) markup on total costs (percentage markup on total costs); and (5) rate of return on assets or capital employed (ratio of operating profit to operating assets).
### Discussion

The TPMs used in APAs completed during 2006 were based on the section 482 regulations. Under Treas. Reg. § 1.482–3, the arm’s length amount for controlled transfers of tangible property may be determined using the Comparable Uncontrolled Price (CUP) method, the Resale Price Method, the Cost Plus Method, the Comparable Profits Method (CPM), or the Profit Split Method. Under Treas. Reg. § 1.482–4, the arm’s length amount for controlled transfers of intangible property may be determined using the Comparable Uncontrolled Transaction (CUT) method, CPM, or the Profit Split Method. An “Unspecified Method” may be used for both tangible and intangible property if it provides a more reliable result than the enumerated methods under the best method rule of Treas. Reg. § 1.482–1(c). For transfers involving the provision of services, Treas. Reg. § 1.482–2(b) provides that services performed for the benefit of another member of a controlled group should bear an arm’s length charge, either deemed to be equal to the cost of providing the services or an amount that would have been charged between independent parties. In addition, Treas. Reg. § 1.482–2(a) provides rules concerning the proper treatment of loans or advances.

Treas. Reg. § 1.482–7 provides rules for qualified cost sharing arrangements under which the parties agree to share the costs of development of intangibles in proportion to their shares of reasonably anticipated benefits. APAs involving cost sharing arrangements generally address both the method of allocating costs among the parties as well as determining the appropriate amount of the “buy-in” payment due for the transfer of pre-existing intangibles to the controlled participants. In 2006, the APA Program completed more than half a dozen cost sharing and/or buy-in APAs, including both outbound and inbound transactions. The majority of these were unilateral, but the APA Program also completed its recommendations on three additional bilateral cost sharing/buy-in cases and sent those on to Competent Authority. The methods used in the buy-in cases included valuations based on comparable uncontrolled transactions, on discounted cash flows, and on market capitalization. In addition, the Program is currently working on approximately half a dozen more cases involving cost sharing/buy-ins, split about evenly between bilateral and unilateral.

In reviewing the TPMs applicable to transfers of tangible and intangible property reflected in Table 19, the majority of the APAs followed the specified methods. However, several points should be made. The section 482 regulations note that for transfers of tangible property, the CUP method will generally be the most direct and reliable measure of an arm’s length price for the Controlled Transaction if sufficiently reliable comparable transactions can be identified. Treas. Reg. § 1.482–3(b)(2)(ii)(A). It was the experience of the APA Program in 2006, that in the cases that came into the APA Program, sufficiently reliable CUP transactions were difficult to find.

Similar to the CUP method, for transfers of intangible property, the CUT method will generally provide the most reliable measure of an arm’s length result if sufficiently reliable comparables may be found. Treas. Reg. § 1.482–4(c)(2)(ii). It has generally been difficult to identify external comparables, and APAs using the CUT method tend to rely on internal transactions between the taxpayer and unrelated parties. In 2006, three or fewer Covered Transactions utilized the CUT TPM.

The Cost Plus Method (tangibles only) and Resale Price Method were each applied in 2006 in three or fewer APAs. See Treas. Reg. § 1.482–3(c), (d).

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

Table 19 reflects more than 54 uses of the CPM (with varying PLIs) in Covered Transactions involving tangible or intangible property. In some APAs, the CPM was also used concurrently with other methods.
The CPM has proven to be versatile in part because of the various PLIs that can be used in connection with the method. Reaching agreement on the appropriate PLI has been the subject of much discussion in many of the cases, and it depends heavily on the facts and circumstances. Some APAs have called for different PLIs to apply to different parts of the Covered Transactions or with one PLI used as a check against the primary PLI.

The CPM was also used regularly with services as the Covered Transactions in APAs executed in 2006. There were at least 13 services Covered Transactions using the CPM method with various PLIs according to the specific facts of the taxpayers involved. Table 20 reflects the methods used to determine the arm’s length results for APAs involving services transactions.

In 2006, 20 APAs involving tangible or intangible property used the Residual Profit Split Method. Treas. Reg. § 1.482–6(c)(3). In residual profit split cases, routine contributions by the controlled parties are allocated routine market returns, and the residual income is allocated among the controlled taxpayers based upon the relative value of their contributions of non-routine intangible property to the relevant business activity.

Profit splits have also been used in a number of financial product APAs in which the primary income-producing functions are performed in more than one jurisdiction.

**Critical Assumptions**

[§ 521(b)(2)(D)(v)]

Critical Assumptions used in APAs executed in 2006 are described in Table 21 below:

<table>
<thead>
<tr>
<th>Critical Assumptions involving the following:</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Material changes to the business</td>
<td>82</td>
</tr>
<tr>
<td>Material changes to tax and/or financial accounting practices</td>
<td>82</td>
</tr>
<tr>
<td>Other financial ratio</td>
<td>7</td>
</tr>
<tr>
<td>Assets will remain substantially same</td>
<td>4</td>
</tr>
<tr>
<td>Cost allocations</td>
<td>4</td>
</tr>
<tr>
<td>Minimum sales volume</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Changes in affiliated companies</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Limit on product line revenues</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Currency fluctuations</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Material sales fluctuations</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Cascathropic events</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Limit on sales to related parties</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Major regulatory changes</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Sales territories substantially same</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Profit projections hold</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
</tr>
</tbody>
</table>
**Discussion**

APAs include critical assumptions upon which their respective TPMs depend. A critical assumption is any fact (whether or not within the control of the taxpayer) related to the taxpayer, a third party, an industry, or business and economic conditions, the continued existence of which is material to the taxpayer’s proposed TPM. Critical assumptions might include, for example, a particular mode of conducting business operations, a particular corporate or business structure, or a range of expected business volume. Rev. Proc. 2006–9, § 4.05. Failure to meet a critical assumption may render an APA inappropriate or unworkable. Most APAs contain only the standard critical assumption language set forth in Appendix B of the Model APA (Attachment A to this Announcement and Report). Where appropriate, additional critical assumption language may be added but the APA Program generally seeks to limit additional critical assumption language to objective, measurable benchmarks.

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

If a critical assumption has not been met, the APA may be revised by agreement of the parties. If such an agreement cannot be achieved, the APA is canceled. If a critical assumption has not been met, it requires taxpayer’s notice to and discussion with the Service, and, in the case of a bilateral APA, competent authority consideration. Rev. Proc. 2006–9, § 11.05, 11.06.

**Sources of Comparables, Selection Criteria, and the Nature of Adjustments to Comparables and Tested Parties**

[§ 521(b)(2)(D)(v), (vi), and (vii)]

The sources of comparables, selection criteria, and rationale used in determining the selection criteria for APAs executed in 2006 are described in Tables 22 through 24 below. Various formulas for making adjustments to comparables are included as Attachment B.

**TABLE 22: SOURCES OF COMPARABLES**

<table>
<thead>
<tr>
<th>Sources</th>
<th>Number of Times This Source Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compustat</td>
<td>73</td>
</tr>
<tr>
<td>Worldscope</td>
<td>19</td>
</tr>
<tr>
<td>Disclosure</td>
<td>13</td>
</tr>
<tr>
<td>Global Vantage</td>
<td>10</td>
</tr>
<tr>
<td>Mergent</td>
<td>7</td>
</tr>
<tr>
<td>Amadeus</td>
<td>5</td>
</tr>
<tr>
<td>Japanese Accounts and Data on Enterprises (“JADE”)</td>
<td>4</td>
</tr>
<tr>
<td>Taxpayer’s information on competition</td>
<td>4</td>
</tr>
<tr>
<td>Moody’s</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>6</td>
</tr>
</tbody>
</table>
**TABLE 23: COMPARABLES SELECTION CRITERIA**

<table>
<thead>
<tr>
<th>Selection Criteria Considered</th>
<th>Number of Times This Criterion Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Comparable functions</td>
<td>90</td>
</tr>
<tr>
<td>Comparable risks</td>
<td>71</td>
</tr>
<tr>
<td>Comparable industry</td>
<td>59</td>
</tr>
<tr>
<td>Comparable products</td>
<td>43</td>
</tr>
<tr>
<td>Comparable intangibles</td>
<td>38</td>
</tr>
<tr>
<td>Comparable terms</td>
<td>10</td>
</tr>
</tbody>
</table>

**TABLE 24: ADJUSTMENTS TO COMPARABLES OR TESTED PARTIES**

<table>
<thead>
<tr>
<th>Adjustment</th>
<th>Number of Times Used</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Balance sheet adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>Inventory</td>
<td>64</td>
</tr>
<tr>
<td>Payables</td>
<td>62</td>
</tr>
<tr>
<td>Receivables</td>
<td>62</td>
</tr>
<tr>
<td>Property, plant, equipment</td>
<td>16</td>
</tr>
<tr>
<td>Other</td>
<td>≤ 3</td>
</tr>
<tr>
<td><strong>Accounting adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>LIFO to FIFO inventory accounting</td>
<td>29</td>
</tr>
<tr>
<td>Accounting reclassifications (e.g., from COGS to operating expenses)</td>
<td>7</td>
</tr>
<tr>
<td>Marketing/ Procurement</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>7</td>
</tr>
<tr>
<td><strong>Profit level indicator adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>Operating expense</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>≤ 3</td>
</tr>
<tr>
<td><strong>Miscellaneous adjustments</strong></td>
<td></td>
</tr>
<tr>
<td>Research &amp; development</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Advertising</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Foreign exchange</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

**Discussion**

At the core of most APAs are comparables. The APA Program works closely with taxpayers to find the best and most reliable comparables for each Covered Transaction. In some cases, CUPs or CUTs can be identified. In other cases, comparable business activities of independent companies are used in applying the CPM or a profit split method. Generally, in the APA Program’s experience since 1991, CUPs and CUTs have been most often derived from the internal transactions of the taxpayer.
For profit-based methods in which comparable business activities or functions of independent companies are sought, the APA Program typically has selected them using a three-part process. First, a pool of potential comparables has been identified through broad searches. From this pool, companies having transactions that are clearly not comparable to those of the tested party have been eliminated through the use of quantitative and qualitative analyses, *i.e.*, quantitative screens and business descriptions. Then, based on a review of available descriptive and financial data, a set of comparable transactions or business activities of independent companies has been finalized. The comparability of the finalized set has then been enhanced through the application of adjustments.

**Sources of Comparables**

Comparables used in APAs can be U.S. or foreign, depending on the relevant market, the type of transaction being evaluated, the availability of relevant data, and the results of the functional and risk analyses. In general, comparables have been located by searching a variety of databases that provide data on U.S. publicly traded companies and on a combination of public and private non-U.S. companies. Table 22 shows the various databases and other sources used in selecting comparables for the APAs executed in 2006.

Although comparables were most often identified from the databases cited in Table 22, in some cases comparables were found from other sources, such as comparables derived internally from taxpayer transactions with third parties.

**Selecting Comparables**

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

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

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

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

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

An additional important class of selection criteria is the development and ownership of intangible property. In some cases in which the business activity being tested is manufacturing, several criteria have been used to ensure, for example, that if the controlled entity does not own significant manufacturing intangibles or conduct research and development (R&D), then neither will the comparables. These selection criteria have included determining the importance of patents to a company or screening for R&D expenditures as a percentage of sales. Again, quantitative screens related to identifying comparables with significant intangible property generally have been used in conjunction with an understanding of the comparable derived from publicly available business information.
Selection criteria relating to asset comparability and operating expense comparability have also been used at times. A screen of property, plant, and equipment (PP&E) as a percentage of sales or assets, combined with a reading of a company’s SEC filings, has been used to help ensure that distributors (generally lower PP&E) were not compared with manufacturers (generally higher PP&E), regardless of their industry classification. Similarly, a test involving the ratio of operating expenses to sales has helped to determine whether a company undertakes a significant marketing and distribution function.

Table 25 shows the number of times various screens were used in APAs executed in 2006:

**TABLE 25: COMPARABILITY SCREENS**

<table>
<thead>
<tr>
<th>Comparability/Financial Distress Screen</th>
<th>Times Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>48</td>
</tr>
<tr>
<td>R&amp;D/ sales</td>
<td>43</td>
</tr>
<tr>
<td>Foreign sales/ total sales</td>
<td>15</td>
</tr>
<tr>
<td>Advertising expense/ sales</td>
<td>14</td>
</tr>
<tr>
<td>PP&amp;E/ sales</td>
<td>6</td>
</tr>
<tr>
<td>SG&amp;A/ sales</td>
<td>5</td>
</tr>
<tr>
<td>Non-startup or start-up</td>
<td>5</td>
</tr>
<tr>
<td>PP&amp;E/ total assets</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Operating expenses/ sales</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Non-startup or startup</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Government sales/ sales</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Inventory/ sales</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Intangible property/ total assets</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Work in process inventory/ total inventory</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

**Financial distress**

<table>
<thead>
<tr>
<th></th>
<th>Times Used</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bankruptcy</td>
<td>48</td>
</tr>
<tr>
<td>Losses in one or more years</td>
<td>33</td>
</tr>
<tr>
<td>Unfavorable auditor’s opinion</td>
<td>31</td>
</tr>
<tr>
<td>Stopped filing public documents</td>
<td>≤ 3</td>
</tr>
<tr>
<td>No sales growth</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

**Adjusting Comparables**

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

The most common balance sheet adjustments used in APAs are adjustments for differences in accounts receivable, inventories, and accounts payable. The APA Program generally has required adjustments for receivables, inventory, and payables based on the principle that there is an opportunity cost for holding assets. For these assets, it is generally assumed that the cost is appropriately measured by the interest rate on short-term debt.
To compare the profits of two business activities with different relative levels of receivables, inventory, or payables, the APA Program estimates the carrying costs of each item and adjusts profits accordingly. Although different formulas have been used in specific APA cases, Attachment B presents one set of formulas used in many APAs. Underlying these formulas are the notions that (1) balance sheet items normally should be expressed as mid-year averages, (2) formulas should try to avoid using data items that are being tested by the TPM (for example, if sales are controlled, then the denominator of the balance sheet ratio should not be sales), (3) a short term interest rate should be used, and (4) an interest factor should recognize the average holding period of the relevant asset. During the course of 2006, the APA Program often used an interest rate equal to LIBOR (3 months) plus 200 basis points for purposes of calculating adjustments for accounts receivable and accounts payable for U.S. companies. However, the facts and circumstances surrounding a given case will ultimately determine the reliability of making balance sheet adjustments and the selection of the most reliable interest rate.

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

Still important in some cases is the adjustment for differences in relative levels of PP&E between a tested business activity and the comparables. Ideally, comparables and the business activity being tested will have fairly similar relative levels of PP&E, since major differences can be a sign of fundamentally different functions and risks. Typically, the PP&E adjustment is made using a medium term interest rate. During the course of 2006, the APA Program often used the Corporate Bonds (Moody’s) Baa rate as the interest rate for purposes of calculating adjustments for inventory and PP&E for U.S. companies. Again, however, the facts and circumstances surrounding a given case will ultimately determine the reliability of making balance sheet adjustments and the selection of the most reliable interest rate.

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

The adjustments made to comparables or tested parties in APAs executed in 2006 are reflected in Table 24 above.

**Ranges, Targets, and Adjustment Mechanisms**

[§ 521(b)(2)(D)(viii)–(ix)]

The types of ranges, targets, and adjustment mechanisms used in APAs executed in 2006 are described in Table 26 and 27 below.

### TABLE 26: RANGES AND TARGETS

<table>
<thead>
<tr>
<th>Type of Range or Target</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interquartile range</td>
<td>68</td>
</tr>
<tr>
<td>Specific point (royalty)</td>
<td>18</td>
</tr>
<tr>
<td>Specific point within CPM range (not floor or ceiling)</td>
<td>13</td>
</tr>
<tr>
<td>Full range</td>
<td>5</td>
</tr>
<tr>
<td>Floor (i.e., result must be no less than x)</td>
<td>4</td>
</tr>
<tr>
<td>Specific point (profit split)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Specific point (CUP)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Ceiling (i.e., result must be no more than x)</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Narrower range within interquartile range</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>5</td>
</tr>
</tbody>
</table>

4 The numbers do not include TPMs with cost or cost-plus methodologies.
TABLE 27: ADJUSTMENT MECHANISMS

<table>
<thead>
<tr>
<th>Adjustment mechanism</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Taxpayer makes an adjustment: to specified point or royalty</td>
<td>41</td>
</tr>
<tr>
<td>rate</td>
<td></td>
</tr>
<tr>
<td>Taxpayer makes an adjustment: to closest edge of single year</td>
<td>28</td>
</tr>
<tr>
<td>Taxpayer makes an adjustment: to closest edge of multi-year</td>
<td>20</td>
</tr>
<tr>
<td>average</td>
<td></td>
</tr>
<tr>
<td>Taxpayer makes an adjustment: to median of current year</td>
<td>12</td>
</tr>
<tr>
<td>Taxpayer makes an adjustment: to median of multi-year average</td>
<td>11</td>
</tr>
<tr>
<td>Taxpayer makes an adjustment: to other</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>≤ 3</td>
</tr>
</tbody>
</table>

Discussion

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

Under Treas. Reg. § 1.482–1(e)(2)(i), such a range is normally derived by considering a set of more than one comparable uncontrolled transaction of similar comparability and reliability. If these comparables are of very high quality, as defined in the section 482 regulations, then under Treas. Reg. § 1.482–1(e)(2)(iii)(A), the arm’s length range includes the results of all of the comparables (from the least to the greatest). However, the APA Program has only rarely identified cases meeting the requirements for the full range. If the comparables are of lesser quality, then under Treas. Reg. § 1.482–1(e)(2)(iii)(B), “the reliability of the analysis must be increased, when it is possible to do so, by adjusting the range through application of a valid statistical method to the results of all of the uncontrolled comparables.” One such method, the “interquartile range,” is ordinarily acceptable, although a different statistical method “may be applied if it provides a more reliable measure.” The “interquartile range” is defined as, roughly, the range from the 25th to the 75th percentile of the comparables’ results. See Treas. Reg. § 1.482–1(e)(2)(iii)(C). The interquartile range was used 68 times in 2006.

Thirty-eight or more Covered Transactions reflected on Table 26 were tested against a single, specific result. Thirteen of these Covered Transactions involved a CPM in which the taxpayer agreed to a “point.” Some APAs – deliberately infrequent – specify not a point or a range, but a “floor” or a “ceiling.” When a floor is used, the tested party’s result must be greater than or equal to some particular value. When a ceiling is used, the tested party’s result must be less than or equal to some particular value. Four APAs executed in 2006 used a floor and three or fewer used a ceiling.

Some APAs look to a tested party’s results over a period of years (multi-year averaging) to determine whether a taxpayer has complied with the APA. In 2006, rolling multi-year averaging was used for 15 Covered Transactions. Ten of those used three-year averages. Nine Covered Transactions used a cumulative multi-year average, while 18 Covered Transactions used term averages and three or fewer Covered Transactions used partial term averages.

Adjustments

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

Where a taxpayer’s actual transactions do not comply with the TPM, a taxpayer must nonetheless report its taxable income in an amount consistent with the TPM (an APA primary adjustment), as further discussed in § 11.02 of Rev. Proc. 2006–9.
APA Term and Rollback Lengths
[§ 521(b)(2)(D)(x)]

The various term lengths for APAs executed in 2006 are set forth in Table 28 below:

**TABLE 28: TERMS OF APAS**

<table>
<thead>
<tr>
<th>APA Term in Years</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>3</td>
<td>6</td>
</tr>
<tr>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>5</td>
<td>46</td>
</tr>
<tr>
<td>6</td>
<td>8</td>
</tr>
<tr>
<td>7</td>
<td>9</td>
</tr>
<tr>
<td>8</td>
<td>6</td>
</tr>
<tr>
<td>9</td>
<td>1</td>
</tr>
<tr>
<td>10 or more</td>
<td>2</td>
</tr>
</tbody>
</table>

The number of rollback years to which an APA TPM was applied in 2006 is set forth in Table 29 below:

**TABLE 29: NUMBER OF YEARS COVERED BY ROLLBACK OF APA TPM**

<table>
<thead>
<tr>
<th>Number of Rollback Years</th>
<th>Number of APAs</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>2</td>
<td>4</td>
</tr>
<tr>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>5 or more</td>
<td>5</td>
</tr>
</tbody>
</table>

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

APAs executed in 2006 required that taxpayers provide various documents with their annual reports. These documents are described in Table 30 below:
### TABLE 30: NATURE OF DOCUMENTATION REQUIRED

<table>
<thead>
<tr>
<th>Documentation</th>
<th>Number of Times Required</th>
</tr>
</thead>
<tbody>
<tr>
<td>Statement identifying all material differences between Taxpayer’s business operations during APA Year and description of Taxpayer’s business operations contained in Taxpayer’s request for APA, or if there have been no such material differences, a statement to that effect</td>
<td>82</td>
</tr>
<tr>
<td>Description of any failure to meet Critical Assumptions or, if there have been none, a statement to that effect</td>
<td>82</td>
</tr>
<tr>
<td>Statement identifying all material changes in Taxpayer’s accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer’s request for APA, or if there have been none, statement to that effect</td>
<td>82</td>
</tr>
<tr>
<td>Description of, reason for, and financial analysis of, any Compensating Adjustments with respect to APA Year, including means by which any Compensating Adjustment has been or will be satisfied</td>
<td>82</td>
</tr>
<tr>
<td>Financial analysis demonstrating Taxpayer’s compliance with TPM</td>
<td>82</td>
</tr>
<tr>
<td>Organizational chart</td>
<td>82</td>
</tr>
<tr>
<td>Financial statements as prepared in accordance with US GAAP</td>
<td>71</td>
</tr>
<tr>
<td>Certified public accountant’s opinion that financial statements present fairly financial position of Taxpayer and the results of its operations, in accordance with US GAAP</td>
<td>71</td>
</tr>
<tr>
<td>Financial statements as prepared in accordance with a foreign GAAP</td>
<td>15</td>
</tr>
<tr>
<td>Certified public accountant’s opinion that financial statements present fairly financial position of Taxpayer and the results of its operations, in accordance with a foreign GAAP</td>
<td>11</td>
</tr>
<tr>
<td>Book to tax reconciliations</td>
<td>9</td>
</tr>
<tr>
<td>Schedule of costs and expenses (e.g., intercompany allocations)</td>
<td>8</td>
</tr>
<tr>
<td>Certified public accountant’s review of financial statements</td>
<td>8</td>
</tr>
<tr>
<td>Various work papers</td>
<td>7</td>
</tr>
<tr>
<td>United States income tax return</td>
<td>5</td>
</tr>
<tr>
<td>Profit &amp; Loss statement</td>
<td>4</td>
</tr>
<tr>
<td>Changes in entity classifications</td>
<td>4</td>
</tr>
<tr>
<td>Changes in Taxpayer notice information</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Description of special accounting treatment for certain income items</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Reconciliation of foreign to US GAAP</td>
<td>≤ 3</td>
</tr>
<tr>
<td>Other</td>
<td>4</td>
</tr>
</tbody>
</table>

**Approaches for Sharing of Currency or Other Risks**

[§ 521(b)(2)(D)(xii)]

During 2006, there were 36 tested parties that faced financial risks, including interest rate and currency risks. In appropriate cases, APAs may provide specific approaches for dealing with currency risk, such as adjustment mechanisms and/or critical assumptions.
Efforts to Ensure Compliance with APAs

[§ 521(b)(2)(F)]

As described in Rev. Proc. 2006–9, § 11.01, APA taxpayers are required to file annual reports to demonstrate compliance with the terms and conditions of the APA. The filing and review of annual reports is a critical part of the APA process. Through annual report review, the APA Program monitors taxpayer compliance with the APA on a contemporaneous basis. Annual report review provides current information on the success or problems associated with the various TPMs adopted in the APA process.

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

The statistics for the review of APA annual reports are reflected in Table 31 below. As of December 31, 2006, there were 256 pending annual reports. In 2006, 537 reports were closed.

<table>
<thead>
<tr>
<th>TABLE 31: STATISTICS OF ANNUAL REPORTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of APA annual reports pending as of December 31, 2006</td>
</tr>
<tr>
<td>Number of APA annual reports closed in Year 2006</td>
</tr>
<tr>
<td>Number of APA annual reports requiring adjustment in Year 2006</td>
</tr>
<tr>
<td>Number of taxpayers involved in adjustments</td>
</tr>
<tr>
<td>Number of APA annual report cases over one year old</td>
</tr>
</tbody>
</table>
ATTACHMENT A
Model APA – Based on Revenue Procedure 2006–9

ADVANCE PRICING AGREEMENT
between
[Insert Taxpayer’s Name]
and
THE INTERNAL REVENUE SERVICE

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

RECITALS
[Insert Taxpayer Name] is the common parent of an affiliated group filing consolidated U.S. tax returns (collectively referred to as “Taxpayer”), and is entering into this APA on behalf of itself and other members of its consolidated group.

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

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

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

AGREEMENT
The Parties agree as follows:
1. Covered Transactions. This APA applies to the Covered Transactions, as defined in Appendix A.
2. Transfer Pricing Method. Appendix A sets forth the Transfer Pricing Method (TPM) for the Covered Transactions.
3. Term. This APA applies to Taxpayer’s taxable years ending ______ through ______ (APA Term).
4. Operation.
   a. Revenue Procedure 2006–9 governs the interpretation, legal effect, and administration of this APA.
   b. Nonfactual oral and written representations, within the meaning of sections 10.04 and 10.05 of Revenue Procedure 2006–9 (including any proposals to use particular TPMs), made in conjunction with the APA Request constitute statements made in compromise negotiations within the meaning of Rule 408 of the Federal Rules of Evidence.
5. Compliance.
   a. Taxpayer must report its taxable income in an amount that is consistent with Appendix A and all other requirements of this APA on its timely filed U.S. Return. However, if Taxpayer’s timely filed U.S. Return for an APA Year is filed prior to, or no later than 60 days after, the effective date of this APA, then Taxpayer must report its taxable income for that APA Year in an amount that is consistent with Appendix A and all other requirements of this APA either on the original U.S. Return or on an amended U.S. Return filed no later than 120 days after the effective date of this APA, or through such other means as may be specified herein.
   b. [Insert when U.S. Group or Foreign Group contains more than one member.] [This APA addresses the arm’s-length nature of prices charged or received in the aggregate between Taxpayer and Foreign Participants with respect to the Covered Transactions. Except as explicitly provided, this APA does not address and does not bind the IRS with respect to prices charged or received, or the relative amounts of income or loss realized, by particular legal entities that are members of U.S. Group or that are members of Foreign Group.]
   c. For each taxable year covered by this APA (APA Year), if Taxpayer complies with the terms and conditions of this APA, then the IRS will not make or propose any allocation or adjustment under I.R.C. section 482 to the amounts charged in the aggregate between Taxpayer and Foreign Participant[s] with respect to the Covered Transactions.
d. If Taxpayer does not comply with the terms and conditions of this APA, then the IRS may:

i. enforce the terms and conditions of this APA and make or propose allocations or adjustments under I.R.C. section 482 consistent with this APA;

ii. cancel or revoke this APA under section 11.06 of Revenue Procedure 2006–9; or

iii. revise this APA, if the Parties agree.

e. Taxpayer must timely file an Annual Report (an original and four copies) for each APA Year in accordance with Appendix C and section 11.01 of Revenue Procedure 2006–9. Taxpayer must file the Annual Report for all APA Years through the APA Year ending [insert year] by [insert date]. Taxpayer must file the Annual Report for each subsequent APA Year by [insert month and day] immediately following the close of that APA Year. (If any date falls on a weekend or holiday, the Annual Report shall be due on the next date that is not a weekend or holiday.) The IRS may request additional information reasonably necessary to clarify or complete the Annual Report. Taxpayer will provide such requested information within 30 days. Additional time may be allowed for good cause.

f. The IRS will determine whether Taxpayer has complied with this APA based on Taxpayer’s U.S. Returns, Financial Statements, and other APA Records, for the APA Term and any other year necessary to verify compliance. For Taxpayer to comply with this APA, an independent certified public accountant must [use the following or an alternative] render an opinion that Taxpayer’s Financial Statements present fairly, in all material respects, Taxpayer’s financial position under U.S. GAAP.

g. In accordance with section 11.04 of Revenue Procedure 2006–9, Taxpayer will (1) maintain its APA Records, and (2) make them available to the IRS in connection with an examination under section 11.03. Compliance with this subparagraph constitutes compliance with the record-maintenance provisions of I.R.C. sections 6038A and 6038C for the Covered Transactions for any taxable year during the APA Term.

h. The True Taxable Income within the meaning of Treasury Regulations sections 1.482–1(a)(1) and (i)(9) of a member of an affiliated group filing a U.S. consolidated return will be determined under the I.R.C. section 1502 Treasury Regulations.

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

6. Critical Assumptions. This APA’s critical assumptions, within the meaning of Revenue Procedure 2006–9, section 4.05, appear in Appendix B. If any critical assumption has not been met, then Revenue Procedure 2006–9, section 11.06, governs.

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

8. Disputes. If a dispute arises concerning the interpretation of this APA, the Parties will seek a resolution by the IRS Associate Chief Counsel (International) to the extent reasonably practicable, before seeking alternative remedies.

9. Materiality. In this APA the terms “material” and “materially” will be interpreted consistently with the definition of “material facts” in Revenue Procedure 2006–9, section 11.06(4).

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

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

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

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

14. Notice. Any notices required by this APA or Revenue Procedure 2006–9 must be in writing. Taxpayer will send notices to the IRS at the address and in the manner set forth in Revenue Procedure 2006–9, section 4.11. The IRS will send notices to:

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

**WITNESS,**

The Parties have executed this APA on the dates below.

[Taxpayer Name in all caps]

By: ____________________________ Date: ________, 20____

Jane Doe
Sr. Vice President (Taxes)

IRS

By: ____________________________ Date: ________, 20____

Matthew W. Frank
Director, Advance Pricing Agreement Program

**APPENDIX A**

**COVERED TRANSACTIONS AND TRANSFER PRICING METHOD (TPM)**

1. **Covered Transactions.**

   *Define the Covered Transactions.*

2. **TPM.**

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

   [The Tested Party is ________]

   *CUP Method*
   
   The TPM is the comparable uncontrolled price (CUP) method. The Arm’s Length Range of the price charged for ________ is between ________ and ________ per unit.

   *CUT Method*
   
   The TPM is the CUT Method. The Arm’s Length Range of the royalty charged for the license of ________ is between _____% and _____% of [Taxpayer’s, Foreign Participants’, or other specified party’s] Net Sales Revenue. [Insert definition of net sales revenue or other royalty base.]

   *Resale Price Method (RPM)*
   
   The TPM is the resale price method (RPM). The Tested Party’s Gross Margin for any APA Year is defined as follows: the Tested Party’s gross profit divided by its sales revenue (as those terms are defined in Treasury Regulations sections 1.482–5(d)(1) and (2)) for that APA Year. The Arm’s Length Range is between _____% and _____%, and the Median of the Arm’s Length Range is _____%.
Cost Plus Method

The TPM is the cost plus method. The Tested Party’s Cost Plus Markup is defined as follows for any APA Year: the Tested Party’s ratio of gross profit to production costs (as those terms are defined in Treasury Regulations sections 1.482–3(d)(1) and (2)) for that APA Year. The Arm’s Length Range is between _____% and _____%, and the Median of the Arm’s Length Range is ____%.

CPM with Berry Ratio PLI

The TPM is the comparable profits method (CPM). The profit level indicator is a Berry Ratio. The Tested Party’s Berry Ratio is defined as follows for any APA Year: the Tested Party’s gross profit divided by its operating expenses (as those terms are defined in Treasury Regulations sections 1.482–5(d)(2) and (3)) for that APA Year. The Arm’s Length Range is between _____% and _____%, and the Median of the Arm’s Length Range is ____%.

CPM using an Operating Margin PLI

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. The Tested Party’s Operating Margin is defined as follows for any APA Year: the Tested Party’s operating profit divided by its sales revenue (as those terms are defined in Treasury Regulations section 1.482–5(d)(1) and (4)) for that APA Year. The Arm’s Length Range is between _____% and _____%, and the Median of the Arm’s Length Range is ____%.

CPM using a Three-year Rolling Average Operating Margin PLI

The TPM is the comparable profits method (CPM). The profit level indicator is an operating margin. The Tested Party’s Three-Year Rolling Average operating margin is defined as follows for any APA Year: the sum of the Tested Party’s operating profit divided by its sales revenue (within the meaning of Treasury Regulations section 1.482–5(d)(4)) for that APA Year and the two preceding years, divided by the sum of its sales revenue (within the meaning of Treasury Regulations section 1.482–5(d)(1)) for that APA Year and the two preceding years. The Arm’s Length Range is between _____% and _____%, and the Median of the Arm’s Length Range is ____%.

Residual Profit Split Method

The TPM is the residual profit split method. [Insert description of routine profit level determinations and residual profit-split mechanism].

[Insert additional provisions as needed.]
APPENDIX B

CRITICAL ASSUMPTIONS

This APA’s critical assumptions are:

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

[Insert additional provisions as needed.]

APPENDIX C

APA RECORDS AND ANNUAL REPORT

APA RECORDS

The APA Records will consist of:

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

ANNUAL REPORT

The Annual Report will include two copies of a properly completed APA Annual Report Summary in the form of Exhibit E to this APA, one copy of the form bound with, and one copy bound separately from, the rest of the Annual Report. In addition, the Annual Report will include a table of contents and the information and exhibits identified below, organized as follows.

1. Statements that fully identify, describe, analyze, and explain:
   a. All material differences between any of the U.S. Entities’ business operations (including functions, risks assumed, markets, contractual terms, economic conditions, property, services, and assets employed) during the APA Year and the description of the business operations contained in the APA Request. If there have been no material differences, the Annual Report will include a statement to that effect.
   b. All material changes in the U.S. Entities’ accounting methods and classifications, and methods of estimation, from those described or used in Taxpayer’s request for this APA. If any such change was made to conform to changes in U.S. GAAP (or other relevant accounting standards), Taxpayer will specifically identify such change. If there has been no material change in accounting methods and classifications or methods of estimation, the Annual Report will include a statement to that effect.
   c. Any change to the Taxpayer notice information in section 14 of this APA.
   d. Any failure to meet any critical assumption. If there has been no failure, the Annual Report will include a statement to that effect.
   e. Any change to any entity classification for federal income tax purposes (including any change that causes an entity to be disregarded for federal income tax purposes) of any Worldwide Group member that is a party to the Covered Transactions or is otherwise relevant to the TPM.
   f. The amount, reason for, and financial analysis of any compensating adjustments under paragraph 4 of Appendix A and Revenue Procedure 2006–9, section 11.02(3), for the APA Year, including but not limited to:
      i. the amounts paid or received by each affected entity;
      ii. the character (such as capital, ordinary, income, expense) and country source of the funds transferred, and the specific affected line item(s) of any affected U.S. Return; and
      iii. the date(s) and means by which the payments are or will be made.
   g. The amounts, description, reason for, and financial analysis of any book-tax difference relevant to the TPM for the APA Year, as reflected on Schedule M–1 or Schedule M–3 of the U.S. Return for the APA Year.

2. The Financial Statements, and any necessary account detail to show compliance with the TPM, with a copy of the independent certified public accountant’s opinion required by paragraph 5(f) of this APA.
3. A financial analysis that reflects Taxpayer’s TPM calculations for the APA Year. The calculations must reconcile with and reference the Financial Statements in sufficient account detail to allow the IRS to determine whether Taxpayer has complied with the TPM.

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

5. A copy of the APA.

APPENDIX D

DEFINITIONS

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

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual Report</td>
<td>A report within the meaning of Revenue Procedure 2006–9, section 11.01.</td>
</tr>
<tr>
<td>APA</td>
<td>This Advance Pricing Agreement, which is an “advance pricing agreement” within the meaning of Revenue Procedure 2006–9, section 2.04.</td>
</tr>
<tr>
<td>APA Records</td>
<td>The records specified in Appendix C.</td>
</tr>
<tr>
<td>APA Request</td>
<td>Taxpayer’s request for this APA dated __________, including any amendments or supplemental or additional information thereto.</td>
</tr>
<tr>
<td>Covered Transaction(s)</td>
<td>This term is defined in Appendix A.</td>
</tr>
<tr>
<td>Financial Statements</td>
<td>Financial statements prepared in accordance with U.S. GAAP and stated in U.S. dollars.</td>
</tr>
<tr>
<td>Foreign Group</td>
<td>Worldwide Group members that are not U.S. persons.</td>
</tr>
<tr>
<td>Foreign Participants</td>
<td>[name the foreign entities involved in Covered Transactions].</td>
</tr>
<tr>
<td>Transfer Pricing Method (TPM)</td>
<td>A transfer pricing method within the meaning of Treasury Regulations section 1.482–1(b) and Revenue Procedure 2006–9, section 2.04.</td>
</tr>
<tr>
<td>U.S. GAAP</td>
<td>U.S. generally-accepted accounting principles.</td>
</tr>
<tr>
<td>U.S. Group</td>
<td>Worldwide Group members that are U.S. persons.</td>
</tr>
<tr>
<td>U.S. Return</td>
<td>For each taxable year, the “returns with respect to income taxes under subtitle A” that Taxpayer must “make” in accordance with I.R.C. section 6012. (Or substitute for partnership: For each taxable year, the “return” that Taxpayer must “make” in accordance with I.R.C. section 6031.)</td>
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<tr>
<td>Worldwide Group</td>
<td>Taxpayer and all organizations, trades, businesses, entities, or branches (whether or not incorporated, organized in the United States, or affiliated) owned or controlled directly or indirectly by the same interests.</td>
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APPENDIX E

APA ANNUAL REPORT SUMMARY FORM

The APA Annual Report Summary on the next page is a required APA Record. The APA Team Leader has supplied some of the information requested on the form. Taxpayer is to supply the remaining information requested by the form and submit the form as part of its Annual Report.

<table>
<thead>
<tr>
<th>APA Annual Report SUMMARY</th>
<th>Department of the Treasury—Internal Revenue Service</th>
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<td>Office of Associate Chief Counsel (International)</td>
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<td>Advance Pricing Agreement Program</td>
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<td></td>
<td>APA no. ____________________</td>
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<td>Economist __________________________</td>
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<td>Intl Examiner __________________________</td>
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<tr>
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<td>CA Analyst ______________________________</td>
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</table>

### APA Information

- **Taxpayer Name:** _________________________________
- **Taxpayer EIN:** ____________ **NAICS:** ____________
- **APA Term:** Taxable years ending ________ to ________
- **Original APA [ ] Renewal APA [ ]**
- **Annual Report due dates:**
  - ________ 200__ for all APA Years through APA Year ending in 200__;
  - for each APA Year thereafter, on ______ [month and day] immediately following the close of the APA Year.
- **Principal foreign country(ies) involved in covered transaction(s):** _______________________
- **Type of APA:** [ ] unilateral [ ] bilateral with ____________
- **Tested party is [ ] US [ ] foreign [ ] both**
- **Approximate dollar volume of covered transactions (on an annual basis) involving tangible goods and services:**
  - [ ] N/A [ ] <$50 million [ ] $50–100 million [ ] $100–250 million [ ] $250–500 million
  - [ ] >$500 million
- **APA tests on (check all that apply):**
  - [ ] annual basis [ ] multi-year basis [ ] term basis
- **APA provides (check all that apply) a:**
  - [ ] range [ ] point [ ] floor only [ ] ceiling only [ ] other ________________
- **APA provides for adjustment (check all that apply) to:**
  - [ ] nearest edge [ ] median [ ] other point
APA Annual Report Information
(to be completed by the Taxpayer)

APA date executed: ________________, 200__
This APA Annual Report Summary is for APA Year(s) ending in 200__ and was filed on ______, 200__
Check here [ ] if Annual Report was filed after original due date but in accordance with extension.
Has this APA been amended or changed? [ ] yes [ ] no  Effective Date: _____________
Has Taxpayer complied with all APA terms and conditions? [ ] yes [ ] no
Were all the critical assumptions met? [ ] yes [ ] no
Has a Primary Compensating Adjustment been made in any APA Year covered by this Annual Report?
[ ] yes [ ] no  If yes, which year(s): 200__
Have any necessary Secondary Compensating Adjustments been made? [ ] yes [ ] no
Did Taxpayer elect APA Revenue Procedure treatment? [ ] yes [ ] no
Any change to the entity classification of a party to the APA? [ ] yes [ ] no
Taxpayer notice information contained in the APA remains unchanged? [ ] yes [ ] no
Taxpayer’s current US principal place of business: (City, State) ________________________

APA Annual Report Checklist of Key Contents
(to be completed by the Taxpayer)

Financial analysis reflecting TPM calculations [ ] yes [ ] no
Financial statements showing compliance with TPM(s) [ ] yes [ ] no
Schedule M–1 or M–3 book-tax differences [ ] yes [ ] no
Current organizational chart of relevant portion of world-wide group [ ] yes [ ] no
Attach copy of APA [ ] yes [ ] no
Other APA records and documents included:
[The information required in the following section should be tailored to the particular case]
________________________________________ [ ] yes [ ] no
________________________________________ [ ] yes [ ] no
________________________________________ [ ] yes [ ] no
________________________________________ [ ] yes [ ] no
________________________________________ [ ] yes [ ] no

Contact Information

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<th>Affiliation and Address</th>
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FORMULAS FOR BALANCE SHEET ADJUSTMENTS

**Definitions of Variables:**

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

**Equations:**

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

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

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

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

Then Adjust Comparables as Follows:

- adjusted sales\(_c\) = sales\(_c\) + RA
- adjusted cogs\(_c\) = cogs\(_c\) + PA - IA
- adjusted opex\(_c\) = opex\(_c\) - PPEA

---

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

Suspected 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.
CI—City.
C.O.—Cooperative.
Ct.D.—Court Decision.
C.Y.—County.
D—Decedent.
D.C.—Dummy Corporation.
D.E.—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
FR—Federal Register.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D. —Treasury Decision.
T.F.F.—Transferee.
TFR—Transferor.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
X—Corporation.
Y—Corporation.
Z—Corporation.
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