

## **HIGHLIGHTS OF THIS ISSUE**

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

### **INCOME TAX**

**T.D. 9533, page 139.**

**REG-118809-11, page 162.**

Final, temporary, and proposed regulations remove any references to, or requirement of reliance on, credit ratings in regulations under various sections of the Code and provide substitute standards of credit-worthiness where appropriate, pursuant to the Dodd-Frank Act.

**T.D. 9534, page 144.**

Final regulations under sections 381(c)(4) and 381(c)(5) of the Code provide guidance regarding the accounting method or combination of methods, including inventory methods, to use following certain corporate reorganizations and tax-free liquidations.

standards of credit-worthiness where appropriate, pursuant to the Dodd-Frank Act.

### **ESTATE TAX**

**Rev. Rul. 2011-17, page 160.**

**Special use value; farms; interest rates.** The 2010 and 2011 interest rates to be used in computing the special use value of farm real property for which an election is made under section 2032A of the Code are listed for estates of decedents.

### **EXCISE TAX**

**T.D. 9533, page 139.**

**REG-118809-11, page 162.**

Final, temporary, and proposed regulations remove any references to, or requirement of reliance on, credit ratings in regulations under various sections of the Code and provide substitute

**Announcements of Disbarments and Suspensions begin on page 164.**  
**Finding Lists begin on page ii.**



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Provide America's taxpayers top-quality service by helping them understand and meet their tax responsibilities and en-

force the law with integrity and fairness to all.

## Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

### **Part I.—1986 Code.**

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

### **Part II.—Treaties and Tax Legislation.**

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

### **Part III.—Administrative, Procedural, and Miscellaneous.**

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

### **Part IV.—Items of General Interest.**

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

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

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

## Section 150.—Definitions and Special Rules

26 CFR 1.150–1: Definitions.

T.D. 9533

DEPARTMENT OF THE  
TREASURY  
Internal Revenue Service  
26 CFR Parts 1 and 48

### Modification of Treasury Regulations Pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains temporary regulations that remove any reference to, or requirement of reliance on, “credit ratings” in regulations under the Internal Revenue Code (Code) and provides substitute standards of credit-worthiness where appropriate. This action is required by the Dodd-Frank Wall Street Reform and Consumer Protection Act, which requires Federal agencies to remove any reference to, or requirement of reliance on, credit ratings from their regulations and to substitute such standard of credit-worthiness as the agency deems appropriate for such regulations. These regulations affect persons subject to various provisions of the Code. The text of these temporary regulations also serves as the text of the proposed regulations set forth in the notice of proposed rulemaking on this subject in this issue of the Bulletin.

DATES: *Effective Date:* These regulations are effective on July 6, 2011.

*Applicability Dates:* For dates of applicability, see §§1.150–1T(a)(4), 1.171–1T(f), 1.197–2T(b)(7),

1.249–1T(f)(3), 1.475(a)–4T(d)(4), 1.860G–2T(g)(3), 1.1001–3T(d), (e), and (g), and 48.4101–1T(1)(5).

FOR FURTHER INFORMATION CONTACT: Arturo Estrada, (202) 622–3900 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

Section 939A(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203 (124 Stat. 1376 (2010)), (the “Dodd-Frank Act”), requires each Federal agency to review its regulations that require the use of an assessment of credit-worthiness of a security or money market instrument, and to review any references or requirements in those regulations regarding credit ratings. Section 939A(b) directs each agency to modify any regulation identified in the review required under section 939A(a) by removing any reference to, or requirement of reliance on, credit ratings and substituting a standard of credit-worthiness that the agency deems appropriate. Numerous provisions under the Code are affected.

These temporary regulations amend the Income Tax Regulations (26 CFR part 1) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code. These sections were added to the Code during different years to serve different purposes. These temporary regulations also amend the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) under section 4101 that provides registration requirements related to Federal fuel taxes.

#### Explanation of Provisions

These temporary regulations remove references to “credit ratings” and “credit agencies” or functionally similar terms in the existing regulations. Some changes involve simple word deletions or substitutions. Others reflect the revision of a sentence to remove the credit rating references. In some cases, multiple sentences have been modified. Where appropriate, substitute standards of credit-worthiness

replace the prior references to credit ratings, credit agencies or functionally similar terms. Language revisions serve solely to remove the references prohibited by section 939A of the Dodd-Frank Act and no additional changes are intended.

*Section 1.150–1.* Section 1.150–1 provides definitions for purposes of sections 103 and 141 through 150. Section 1.150–1(b) defines *issuance costs* to mean costs to the extent incurred in connection with, and allocable to, the issuance of an issue within the meaning of section 147(g). Section 1.150–1(b) lists as non-exclusive examples of issuance costs: underwriters’ spread; counsel fees; financial advisory fees; rating agency fees; trustee fees; paying agent fees; bond registrar, certification, and authentication fees; accounting fees; printing costs for bonds and offering documents; public approval process costs; engineering and feasibility study costs; guarantee fees, other than for qualified guarantees (as defined in §1.148–4(f)); and similar costs. These temporary regulations replace the §1.150–1(b) reference to rating agency fees with “fees paid to an organization to evaluate the credit quality of the issue.” No substantive change is intended.

*Section 1.171–1.* The temporary regulations change *credit rating* in §1.171–1(f) *Example 2* (i) to *credit quality*. The change does not affect the analysis in the example. In addition, the temporary regulations make other nonsubstantive changes to the example (for example, the dates in the example are updated).

*Section 1.197–2(b)(7).* The temporary regulations remove “the existence of a favorable credit rating” from the examples of supplier-based intangibles in the third sentence of §1.197–2(b)(7). No substantive change in the treatment of a favorable credit rating as a supplier-based intangible under section 197 is intended.

*Section 1.249–1.* The temporary regulations change *credit rating* and *ratings of credit rating services* in §1.249–1(e)(2)(ii) to *credit quality* and *widely published financial information*. In the existing regulations, a change in the credit rating of an issuer or obligation is one of the facts and circumstances used to determine how

much of a repurchase premium is attributable to the cost of borrowing and not to the conversion feature of a convertible bond. *Credit rating services* is used as a means to determine the credit rating of an issuer or obligation. None of these changes affect the substantive rules in the existing regulations.

*Section 1.475(a)–4(d)(4).* *Example 1, Example 2, and Example 3* in §1.475(a)–4(d)(4) are revised to remove references to credit ratings or credit rating agencies. In these three examples in the existing regulations, *credit rating* or specific references to certain ratings by certain credit ratings agencies (such as AA/aa or AAA/aaa) were used to set up the factual scenario that illustrates the factors that go into the determination of whether it is appropriate for a dealer to take a credit risk adjustment. These terms were also used to describe the credit risk adjustment implicit in the yield curve used to discount the present value of the cash flows. This adjustment affects whether any additional credit risk adjustments are warranted. These examples also used *credit rating agency* to set up the factual scenario that a counterparty's credit-worthiness was based upon an industry standard of a certain credit quality and illustrates the factors that go into the determination of whether it is appropriate for a dealer to take a credit risk adjustment. The changes that have been made to the language of the examples do not alter the purpose of the illustrations and present the factual issues in a more generalized way.

*Section 1.860G–2.* *Section 1.860G–2(g)(2)* defines *qualified reserve fund* as an amount that is reasonably required to fund expenses of the REMIC or amounts due on regular or residual interests in the event of defaults on the underlying pool of mortgages. In defining the amount reasonably required, §1.860G–2(g)(3)(ii) refers to the amount required by a nationally recognized independent rating agency as a condition of providing the rating for the REMIC interest desired by the sponsor. Because an alternative and fully adequate standard of reference is already set forth in these regulations, these temporary regulations remove the rating agency alternative standard.

*Section 1.1001–3.* *Section 1.1001–3* provides rules for determining whether

a modification of a debt instrument results in an exchange for purposes of §1.1001–1(a). These temporary regulations remove the terms *rating* and *credit rating* from §1.1001–3 and generally replace those terms with *credit quality*. *Section 1.1001–3(d) Example 9* is revised so that the event that triggers an option to increase a note's rate of interest is a breach of certain covenants in the note, rather than a specific decline in the corporation's credit rating. The temporary regulations also revise §1.1001–3(g) *Example 5* so that the debt instrument described in the example allows a party to be substituted for the instrument's original obligor on the basis of the party's credit-worthiness, rather than the party's credit rating. The temporary regulations also revise §1.1001–3(g) *Example 8* to explain that a bank's letter of credit supporting a debt instrument is substituted for another bank's letter of credit when the first bank encounters financial difficulty, thus removing references to *rating agencies* and either bank's *credit rating*.

*Section 48.4101–1(f)(4).* *Section 4101* requires certain persons to be registered by the IRS for purposes of several fuel tax provisions of the Code. Under §48.4101–1, the IRS will register an applicant for registration only if, among other conditions, the applicant has adequate financial resources to pay its expected fuel tax liability. To make this determination, §48.4101–1(f)(4)(ii)(B) instructs the IRS to look to the applicant's financial information. These temporary regulations remove the examples of the types of documents the IRS should review and instructs the IRS to look at all information relevant to the applicant's financial status.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. 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. For applicability of the Regulatory Flexibility Act (5 U.S.C. chapter 6), please refer to the Special Analysis section in the preamble to the cross-referenced notice of

proposed rulemaking 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 their impact on small business.

### Drafting Information

These regulations were drafted by personnel in the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of the Associate Chief Counsel (International) and the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

### Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 48 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. *Section 1.150–1* is amended as follows:

1. Paragraph (a)(4) is added.
2. In paragraph (b), the definition of *Issuance costs* is revised.

The additions and revisions read as follows:

#### *§1.150–1 Definitions.*

(a) \* \* \*

(4) [Reserved]. For further guidance, see §1.150–1T(a)(4).

(b) \* \* \*

*Issuance costs* [Reserved]. For further guidance, see §1.150–1T(b), *Issuance costs*.

\* \* \* \* \*

Par. 3. *Section 1.150–1T* is added to read as follows:

#### *§1.150–1T Definitions (temporary).*

(a) through (a)(3) [Reserved]. For further guidance, see §1.150–1(a) through (a)(3).

(4) *Additional exception to the general applicability date.* Section 1.150-1T(b), *Issuance costs*, applies on and after July 6, 2011.

(5) *Expiration date.* The applicability of §1.150-1T(b), *Issuance costs*, expires on or before July 3, 2014.

(b) *Bond* through the definition of *Governmental bond* [Reserved]. For further guidance, see §1.150-1(b) *Bond* through the definition of *Governmental bond*.

*Issuance costs* means costs to the extent incurred in connection with, and allocable to, the issuance of an issue within the meaning of section 147(g). For example, issuance costs include the following costs but only to the extent incurred in connection with, and allocable to, the borrowing: underwriters' spread; counsel fees; financial advisory fees; fees paid to an organization to evaluate the credit quality of an issue; trustee fees; paying agent fees; bond registrar, certification, and authentication fees; accounting fees; printing costs for bonds and offering documents; public approval process costs; engineering and feasibility study costs; guarantee fees, other than for qualified guarantees (as defined in §1.148-4(f)); and similar costs.

(c) *Issue date* through paragraph (e) [Reserved]. For further guidance, see §1.150-1(b) *Issue date* through paragraph (e).

Par. 4. Section 1.171-1(f) *Example 2* is revised to read as follows:

*§1.171-1 Bond premium.*

\*\*\*\*\*  
(f) \*\*\*

*Example 2.* [Reserved]. For further guidance, see §1.171-1T(f) *Example 2*.

\*\*\*\*\*

Par. 5. Section 1.171-1T is added to read as follows:

*§1.171-1T Bond premium (temporary).*

(a) through (f) *Example 1* [Reserved]. For further guidance, see §1.171-1(a) through (f) *Example 1*.

*Example 2. Convertible bond—(i) Facts.* On January 1, 2012, A purchases for \$1,100 B corporation's bond maturing on January 1, 2015, with a stated principal amount of \$1,000, payable at maturity. The bond provides for unconditional payments of interest of \$30 on January 1 and July 1 of each year. In addition, the bond is convertible into 15 shares of B corporation stock at the option of the holder.

On January 1, 2012, B corporation's nonconvertible, publicly-traded, three-year debt of comparable credit quality trades at a price that reflects a yield of 6.75 percent, compounded semiannually.

(ii) *Determination of basis.* A's basis for determining loss on the sale or exchange of the bond is \$1,100. As of January 1, 2012, discounting the remaining payments on the bond at the yield at which B's similar nonconvertible bonds trade (6.75 percent, compounded semiannually) results in a present value of \$980. Thus, the value of the conversion option is \$120. Under §1.171-1(e)(1)(iii)(A), A's basis is \$980 (\$1,100 - \$120) for purposes of §§1.171-1 through 1.171-5. The sum of all amounts payable on the bond other than qualified stated interest is \$1,000. Because A's basis (as determined under §1.171-1(e)(1)(iii)(A)) does not exceed \$1,000, A does not acquire the bond at a premium.

(iii) *Effective/applicability date.* This *Example 2* applies to bonds acquired on or after July 6, 2011.

(g) *Expiration date.* The applicability of this section expires on July 3, 2014.

Par. 6. Section 1.197-2 is amended by revising paragraph (b)(7) to read as follows:

*§1.197-2 Amortization of goodwill and certain other intangibles.*

\*\*\*\*\*

(b) \*\*\*  
(7) [Reserved]. For further guidance, see §1.197-2T(b)(7).

\*\*\*\*\*

Par. 7. Section 1.197-2T is added to read as follows:

*§1.197-2T Amortization of goodwill and certain other intangibles (temporary).*

(a) through (b)(6) [Reserved]. For further guidance, see §1.197-2(a) through (b)(6).

(7) *Supplier-based intangibles—(i) In general.* Section 197 intangibles include any supplier-based intangible. A *supplier-based intangible* is the value resulting from the future acquisition, pursuant to contractual or other relationships with suppliers in the ordinary course of business, of goods or services that will be sold or used by the taxpayer. Thus, the amount paid or incurred for supplier-based intangibles includes, for example, any portion of the purchase price of an acquired trade or business attributable to the existence of a favorable relationship with persons providing distribution services (such as favorable shelf or display space at a retail

outlet), or the existence of favorable supply contracts. The amount paid or incurred for supplier-based intangibles does not include any amount required to be paid for the goods or services themselves pursuant to the terms of the agreement or other relationship. In addition, see the exceptions in §1.197-2(c), including the exception in §1.197-2(c)(6) for certain rights to receive tangible property or services from another person.

(ii) *Effective/applicability date.* This section applies to supplier-based intangibles acquired after July 6, 2011.

(iii) *Expiration date.* The applicability of this section expires on July 3, 2014.

(b)(8) through (l) [Reserved]. For further guidance, see §1.197-2(b)(8) through (l).

Par. 8. Section 1.249-1 is amended as follows:

1. Paragraph (e)(2)(ii) is revised.
2. The paragraph heading for paragraph (f) is revised.
3. Paragraph (f)(3) is added.

The revisions and addition read as follows:

*§1.249-1 Limitation on deduction of bond premium on repurchase.*

\*\*\*\*\*

(e) \*\*\*  
(2) \*\*\*

(ii) [Reserved]. For further guidance, see §1.249-1T(e)(2)(ii).

\*\*\*\*\*

(f) *Effective/applicability dates.* \*\*\*  
(3) [Reserved]. For further guidance, see §1.249-1T(f)(3).

\*\*\*\*\*

Par. 9. Section 1.249-1T is added to read as follows:

*§1.249-1T Limitation on deduction of bond premium on repurchase (temporary).*

(a) through (e)(2)(i) [Reserved]. For further guidance, see §1.249-1(a) through (e)(2)(i).

(ii) In determining the amount under §1.249-1(e)(2)(i), appropriate consideration shall be given to all factors affecting the selling price or yields of comparable nonconvertible obligations. Such factors include general changes in prevailing yields of comparable obligations between

the dates the convertible obligation was issued and repurchased and the amount (if any) by which the selling price of the non-convertible obligation was affected by reason of any change in the issuing corporation's credit quality or the credit quality of the obligation during such period (determined on the basis of widely published financial information or on the basis of other relevant facts and circumstances which reflect the relative credit quality of the corporation or the comparable obligation).

(e)(2)(iii) through (f)(2) [Reserved]. For further guidance, see §1.249-1(e)(2)(iii) through (f)(2).

(3) *Portion of repurchase premium attributable to cost of borrowing.* Paragraph (e)(2)(ii) of this section applies to any repurchase of a convertible obligation occurring on or after July 6, 2011.

(g) [Reserved]. For further guidance, see §1.249-1(g).

(h) *Expiration date.* The applicability of this section expires on July 3, 2014.

Par. 10. Section 1.475(a)-4 is amended by revising paragraph (d)(4) *Example 1*, *Example 2*, and *Example 3* to read as follows:

*§1.475(a)-4 Valuation safe harbor.*

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \*

*Example 1.* [Reserved]. For further guidance, see §1.475(a)-4T(d)(4) *Example 1*.

*Example 2.* [Reserved]. For further guidance, see §1.475(a)-4T(d)(4) *Example 2*.

*Example 3.* [Reserved]. For further guidance, see §1.475(a)-4T(d)(4) *Example 3*.

\* \* \* \* \*

Par. 11. Section 1.475(a)-4T is added to read as follows:

*§1.475(a)-4T Valuation safe harbor (temporary).*

(a) through (d)(4) introductory text [Reserved]. For further guidance, see §1.475(a)-4(a) through (d)(4) introductory text.

*Example 1.* (i) X, a calendar year taxpayer, is a dealer in securities within the meaning of section 475(c)(1). X generally maintains a balanced portfolio of interest rate swaps and other interest rate derivatives, capturing bid-ask spreads and keeping its mar-

ket exposure within desired limits (using, if necessary, additional derivatives for this purpose). X uses a mark-to-market method on a statement that it is required to file with the United States Securities and Exchange Commission and that satisfies §1.475(a)-4(d)(2) with respect to both the contracts with customers and the additional derivatives. When determining the amount of any gain or loss realized on a sale, exchange, or termination of a position, X makes a proper adjustment for amounts taken into account respecting payments or receipts. X and all of its counterparties on the derivatives have the same general credit quality as each other.

(ii) Under X's valuation method, as of each valuation date, X determines a mid-market probability distribution of future cash flows under the derivatives and computes the present values of these cash flows. In computing these present values, X uses an industry standard yield curve that is appropriate for obligations by persons with this same general credit quality. In addition, based on information that includes its own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from the general credit quality used in the yield curve to present value the derivatives.

(iii) X's methodology does not violate the requirement in §1.475(a)-4(d)(3)(iii) that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iv) This *Example 1* applies to valuations of securities on or after July 6, 2011.

*Example 2.* (i) The facts are the same as in *Example 1*, except that X uses a better credit quality in determining the yield curve to discount the payments to be received under the derivatives. Based on information that includes its own knowledge about the counterparties, X adjusts these present values to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from this better credit quality obligation.

(ii) X's methodology does not violate the requirement in §1.475(a)-4(d)(3)(iii) that the same cost or risk not be taken into account, directly or indirectly, more than once.

(iii) This *Example 2* applies to valuations of securities on or after July 6, 2011.

*Example 3.* (i) The facts are the same as in *Example 1*, except that, after computing present values using the discount rates that are appropriate for obligors with the same general credit quality, and based on information that includes X's own knowledge about the counterparties, X adjusts some of these present values either upward or downward to reflect X's reasonable judgment about the extent to which the true credit status of each counterparty's obligation, taking credit enhancements into account, differs from a better credit quality.

(ii) X's methodology violates the requirement in §1.475(a)-4(d)(3)(iii) that the same cost or risk not be taken into account, directly or indirectly, more than once. By using the same general credit quality discount rate, X's method takes into account the difference between risk-free obligations and obligations with that lower credit quality. By adjusting values for the difference between a higher credit quality and

that lower credit quality, X takes into account risks that it had already accounted for through the discount rates that it used. The same result would occur if X judged some of its counterparties' obligations to be of a higher credit quality but X failed to adjust the values of those obligations to reflect the difference between a higher credit quality and the lower credit quality.

(iii) This *Example 3* applies to valuations of securities on or after July 6, 2011.

*Example 4* and *Example 5* and paragraphs (e) through (m). [Reserved]. For further guidance, see §1.475(a)-4(d)(4) *Example 4* and *Example 5* and paragraphs (e) through (m).

(n) *Expiration date.* The applicability of this section expires on July 3, 2014.

Par. 12. Section 1.860G-2 is amended by revising paragraphs (g)(3)(ii)(B) and (C) and adding paragraph (D) to read as follows:

*§1.860G-2 Other rules.*

\* \* \* \* \*

(g) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(B) [Reserved]. For further guidance, see §1.860G-2T(g)(3)(ii)(B).

(C) [Reserved]. For further guidance, see §1.860G-2T(g)(3)(ii)(C).

(D) [Reserved]. For further guidance, see §1.860G-2T(g)(3)(ii)(D).

\* \* \* \* \*

Par. 13. Section 1.860G-2T is added to read as follows:

*§1.860G-2T Other rules (temporary).*

(a) through (g)(3)(ii)(A) [Reserved]. For further guidance, see §1.860G-2(a) through (g)(3)(ii)(A).

(B) *Presumption that a reserve is reasonably required.* The amount of a reserve fund is presumed to be reasonable (and an excessive reserve is presumed to have been promptly and appropriately reduced) if it does not exceed the amount required by a third party insurer or guarantor, who does not own directly or indirectly (within the meaning of section 267(c)) an interest in the REMIC (as defined in section 1.860D-1(b)(1)), as a condition of providing credit enhancement.

(C) *Presumption may be rebutted.* The presumption in §1.860G-2(g)(3)(ii)(B) may be rebutted if the amounts required by the third party insurer are not commercially reasonable considering the factors described in §1.860G-2(g)(3)(ii)(A).

(D) *Effective/applicability date.* Paragraphs (g)(3)(ii)(B) and (C) of this section apply on and after July 6, 2011.

(E) *Expiration date.* The applicability of paragraphs (g)(3)(ii)(B) and (C) of this section expire on July 3, 2014.

(h) through (k) [Reserved]. For further guidance, see §1.860G-2(h) through (k).

Par. 14. Section 1.1001-3 is amended as follows:

1. Paragraph (d) *Example 9* is revised.
2. Paragraph (e)(4)(iv)(B) is revised.
3. Paragraph (e)(5)(ii)(B)(2) is revised.
4. Paragraph (g) *Examples 1, 5 and 8* are revised.

The revisions read as follows:

*§1.1001-3 Modifications of debt instruments.*

\* \* \* \* \*

(d) \* \* \*

*Example 9.* [Reserved]. For further guidance, see §1.1001-3T(d) *Example 9.*

\* \* \* \* \*

(e) \* \* \*

(4) \* \* \*

(iv) \* \* \*

(B) [Reserved]. For further guidance, see §1.1001-3T(e)(4)(iv)(B).

\* \* \* \* \*

(5) \* \* \*

(ii) \* \* \*

(B) \* \* \*

(2) [Reserved]. For further guidance, see §1.1001-3T(e)(5)(ii)(B)(2).

\* \* \* \* \*

(g) \* \* \*

*Example 1.* [Reserved]. For further guidance, see §1.1001-3T(g) *Example 1.*

\* \* \* \* \*

*Example 5.* [Reserved]. For further guidance, see §1.1001-3T(g) *Example 5.*

\* \* \* \* \*

*Example 8.* [Reserved]. For further guidance, see §1.1001-3T(g) *Example 8.*

\* \* \* \* \*

Par. 15. Section 1.1001-3T is added to read as follows:

*§1.1001-3T Modifications of debt instruments (temporary).*

(a) through (d) *Example 8* [Reserved]. For further guidance, see §1.1001-3(a) through (d) *Example 8.*

*Example 9. Holder's option to increase interest rate.* (i) A corporation issues an 8-year note to a bank in exchange for cash. Under the terms of the note, the bank has the option to increase the rate of interest by a specified amount if certain covenants in the note are breached. The bank's right to increase the interest rate is a unilateral option as described in §1.1001-3(c)(3).

(ii) A covenant in the note is breached. The bank exercises its option to increase the rate of interest. The increase in the rate of interest occurs by operation of the terms of the note and does not result in a deferral or a reduction in the scheduled payments or any other alteration described in §1.1001-3(c)(2). Thus, the change in interest rate is not a modification.

(iii) *Effective/applicability date.* This *Example 9* applies to modifications occurring on or after July 6, 2011.

(d) *Example 10* through (e)(4)(iv)(A) [Reserved]. For further guidance, see §1.1001-3(d) *Example 10* through (e)(4)(iv)(A).

(B) *Nonrecourse debt instruments.* (1) A modification that releases, substitutes, adds or otherwise alters a substantial amount of the collateral for, a guarantee on, or other form of credit enhancement for a nonrecourse debt instrument is a significant modification. A substitution of collateral is not a significant modification, however, if the collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and credit quality). In addition, the substitution of a similar commercially available credit enhancement contract is not a significant modification, and an improvement to the property securing a nonrecourse debt instrument does not result in a significant modification.

(2) *Effective/applicability date.* This paragraph (e)(4)(iv)(B) applies to modifications occurring on or after July 6, 2011.

(e)(4)(v) through (e)(5)(ii)(B)(1) [Reserved]. For further guidance, see §1.1001-3(e)(4)(v) through (e)(5)(ii)(B)(1).

(2) *Original collateral.* (i) A modification that changes a recourse debt instrument to a nonrecourse debt instrument is not a significant modification if the instrument continues to be secured only by the original collateral and the modification does not result in a change in payment expectations. For this purpose, if the original collateral is fungible or otherwise of a type where the particular units pledged are unimportant (for example, government securities or financial instruments of a particular type and credit quality), replacement of some or all units of the original collateral with other units of the same or similar type and aggregate value is not considered a change in the original collateral.

(ii) *Effective/applicability date.* This paragraph (e)(5)(ii)(B)(2) applies to modifications occurring on or after July 6, 2011.

(e)(6) through (g) introductory text [Reserved]. For further guidance, see §1.1001-3(e)(6) through (g) introductory text.

*Example 1. Modification of call right.* (i) Under the terms of a 30-year, fixed-rate bond, the issuer can call the bond for 102 percent of par at the end of ten years or for 101 percent of par at the end of 20 years. At the end of the eighth year, the holder of the bond pays the issuer to waive the issuer's right to call the bond at the end of the tenth year. On the date of the modification, the issuer's credit quality is approximately the same as when the bond was issued, but market rates of interest have declined from that date.

(ii) The holder's payment to the issuer changes the yield on the bond. Whether the change in yield is a significant modification depends on whether the yield on the modified bond varies from the yield on the original bond by more than the change in yield as described in §1.1001-3(e)(2)(ii).

(iii) If the change in yield is not a significant modification, the elimination of the issuer's call right must also be tested for significance. Because the specific rules of §1.1001-3(e)(2) through (e)(6) do not address this modification, the significance of the modification must be determined under the general rule of §1.1001-3(e)(1).

(iv) *Effective/applicability date.* This *Example 1* applies to modifications occurring on or after July 6, 2011.

*Example 2* through *Example 4* [Reserved]. For further guidance, see §1.1001-3(g) *Example 2* through *Example 4.*

*Example 5. Assumption of mortgage with increase in interest rate.* (i) A recourse debt instrument with a 9 percent annual yield is secured by an office building. Under the terms of the instrument, a purchaser of the building may assume the debt and be substituted for the original obligor if the purchaser is equally or more creditworthy than the original obligor and if the interest rate on the instrument is increased by one-half percent (50 basis points). The building is sold, the purchaser assumes the debt, and the interest rate increases by 50 basis points.

(ii) If the purchaser's acquisition of the building does not satisfy the requirements of §1.1001-3(e)(4)(i)(B) or (C), the substitution of the purchaser as the obligor is a significant modification under §1.1001-3(e)(4)(i)(A).

(iii) If the purchaser acquires substantially all of the assets of the original obligor, the assumption of the debt instrument will not result in a significant modification if there is not a change in payment expectations and the assumption does not result in a significant alteration.

(iv) The change in the interest rate, if tested under the rules of §1.1001-3(e)(2), would result in a significant modification. The change in interest rate that results from the transaction is a significant alteration. Thus, the transaction does not meet the requirements of §1.1001-3(e)(4)(i)(C) and is a significant modification under §1.1001-3 (e)(4)(i)(A).

(v) *Effective/applicability date.* Notwithstanding §1.1001-3(h), this *Example 5* applies to modifications occurring on or after July 6, 2011.

*Example 6* through *Example 7* [Reserved]. For further guidance, see §1.1001-3(g) *Example 6* through *Example 7*.

*Example 8. Substitution of credit enhancement contract.* (i) Under the terms of a recourse debt instrument, the issuer's obligations are secured by a letter of credit from a specified bank. The debt instrument does not contain any provision allowing a substitution of a letter of credit from a different bank. The specified bank, however, encounters financial difficulty. The issuer and holder agree that the issuer will substitute a letter of credit from another bank.

(ii) Under §1.1001-3(e)(4)(iv)(A), the substitution of a different credit enhancement contract is not a significant modification of a recourse debt instrument unless the substitution results in a change in payment expectations. While the substitution of a new letter of credit by a different bank does not itself result in a change in payment expectations, such a substitution may result in a change in payment expectations under certain circumstances (for example, if the obligor's capacity to meet payment obligations is dependent on the letter of credit and the substitution substantially enhances that capacity from primarily speculative to adequate).

(iii) *Effective/applicability date.* This *Example 8* applies to modifications occurring on or after July 6, 2011.

*Example 9* through (h) [Reserved]. For further guidance, see §1.1001-3(g) *Example 9* through (h).

(i) *Expiration date.* The applicability of this section expires on July 3, 2014.

## PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 16. The authority citation for part 48 continues to read in part as follows:

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

Par. 17. Section 48.4101-1 is amended as follows:

1. Paragraph (f)(4)(ii)(B) is removed and reserved.

2. Paragraph (l)(5) is added and reserved.

The additions read as follows:

§48.4101-1 *Taxable fuel; registration.*

\* \* \* \* \*

(f) \* \* \*

(4) \* \* \*

(ii) \* \* \*

(B) [Reserved]. For further guidance, see §48.4101-1T(f)(4)(ii)(B).

\* \* \* \* \*

(l) \* \* \*

(5) [Reserved]. For further guidance, see §48.4101-1T(l)(5).

Par. 18. Section 48.4101-1T is amended as follows:

1. Paragraphs (a) through (f)(4)(ii)(A) are reserved.

2. Paragraph (f)(4)(ii)(B) is revised.

3. Paragraphs (f)(4)(iii) through (h)(3)(iii) are reserved.

4. Paragraphs (h)(3)(v) through (l)(4) are reserved.

5. Paragraphs (l)(5) and (l)(6) are added.

The additions and revisions read as follows:

§48.4101-1T *Taxable fuel; registration (temporary).*

(a) through (f)(4)(ii)(A) [Reserved]. For further guidance see §48.4104-1(a) through (f)(4)(ii)(A).

(B) *Basis for determination.* The determination under §48.4101-1(f)(4)(ii) must be based on all information relevant to the applicant's financial status.

(f)(4)(iii) through (h)(3)(iii) [Reserved]. For further guidance, see §48.4101-1(f)(4)(iii) through (h)(3)(iii).

\* \* \* \* \*

(h)(3)(v) through (l)(4) [Reserved]. For further guidance, see §48.4101-1(h)(3)(v) through (l)(4).

(l)(5) *Effective/applicability date.* Paragraph (f)(4)(ii)(B) of this section applies on July 6, 2011.

(l)(6) *Expiration date.* The applicability of paragraph (f)(4)(ii)(B) of this section expires on July 3, 2014.

Steven T. Miller,  
Deputy Commissioner for  
Services and Enforcement.

Approved June 29, 2011.

Emily S. McMahon,  
Acting Assistant Secretary of  
the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on July 1, 2011, 11:15 a.m., and published in the issue of the Federal Register for July 6, 2011, 76 F.R. 39278)

## Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(a)-1: General rule relating to carryovers in certain corporate acquisitions.

### T.D. 9534

## DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

### Methods of Accounting Used by Corporations That Acquire the Assets of Other Corporations

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the methods of accounting, including the inventory methods, to be used by corporations that acquire the assets of other corporations in certain corporate reorganizations and tax-free liquidations. These regulations clarify and simplify the rules regarding the accounting methods to be used following these reorganizations and liquidations.

DATES: *Effective Date:* These regulations are effective on August 31, 2011.

*Applicability Date:* For dates of applicability, see §§1.381(a)-1(e), 1.381(c)(4)-1(f), 1.381(c)(5)-1(f), and 1.446-1(e)(4)(iii).

FOR FURTHER INFORMATION CONTACT: Cheryl Oseekey at (202) 622-4970 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

This document contains amendments to 26 CFR part 1. On November 16, 2007, the IRS and the Treasury Department published a notice of proposed rulemaking (REG-151884-03, 2007-2 C.B. 1200) in the **Federal Register** (72 FR 64545). This notice of proposed rulemaking, while continuing most of the provisions of the

regulations originally issued under sections 381(c)(4) and 381(c)(5) of the Internal Revenue Code (Code) regarding the methods of accounting to be used by a corporation that acquires the assets of another corporation in a section 381(a) transaction, proposed to clarify and simplify those existing regulations. The IRS received no comments in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations, as revised by this Treasury decision, are adopted as final regulations.

### Explanation of Provisions

The final regulations differ somewhat in organization and format from the notice of proposed rulemaking. These changes are intended to be editorial in nature and are not intended to alter the substance and principles of the rules set forth in the notice of proposed rulemaking. The IRS and the Treasury Department made these changes to further advance the objective, as expressed in the preamble to the notice of proposed rulemaking, of reducing uncertainty and controversy by providing regulations under sections 381(c)(4) and 381(c)(5) that are clear, consistent, and administrable. For example, the final regulations under sections 381(c)(4) and 381(c)(5) have been drafted so that the regulations mirror each other to the greatest extent possible, thus highlighting the consistencies of the regulations' provisions. Similarly, many of the examples in the notice of proposed rulemaking have been revised in the final regulations to specify the substantive tax rule in the regulations that the examples illustrate. Additionally, new examples were added to the final regulations to provide further illustrations of the substantive tax rules in these regulations.

The keystone of the final regulations for sections 381(c)(4) and 381(c)(5) continues to be whether the acquiring corporation operates the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses following the date of distribution or transfer. The final regulations continue to provide that when the acquiring corporation operates the trades or businesses of the parties as separate and distinct trades or businesses after the date of distribution or

transfer, the acquiring corporation will use a carryover method. In contrast, when the acquiring corporation does not operate the trades or businesses of the parties as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation will use a principal method. These rules do not apply when a carryover method or principal method, as applicable, is not a permissible method, or when the acquiring corporation chooses not to use a carryover method or principal method. In those cases, the general rules under section 446(e) that govern methods of accounting apply.

The final regulations modify the test for determining a principal method when the acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer. Under the final regulations, the determination of whether the distributor or transferor corporation is larger than the acquiring corporation is made by comparing certain attributes (that is, under section 381(c)(4) the adjusted bases of the assets and gross receipts, and under section 381(c)(5) the fair market value of the inventory) of only the trades or businesses that will be integrated after the date of distribution or transfer rather than comparing the attributes for the entire entity. The IRS and the Treasury Department believe that the attributes of a trade or business that will continue to operate as a separate and distinct trade or business after the date of distribution or transfer should not influence the determination of a principal method that will be used by trades or businesses that will be integrated after the date of distribution or transfer. The IRS and the Treasury Department also believe that applying the test at the trade or business level is consistent with §1.446-1(d) because methods of accounting are generally determined at the trade or business level.

The final regulations also provide rules on how an acquiring corporation identifies a principal method when an acquiring corporation or a distributor or transferor corporation operates more than one separate and distinct trade or business on the date of distribution or transfer, has more than one method of accounting used in the trades or businesses, and the acquiring corporation combines the trades or businesses after the

date of distribution or transfer. While the IRS and the Treasury Department do not think these situations occur frequently, the final regulations are revised to provide certainty for an acquiring corporation and to obviate the need to obtain a ruling in these situations.

The final regulations under sections 381(c)(4) and 381(c)(5) clarify the definition of "cut-off basis." The final regulations provide that *cut-off basis* generally means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made to a principal method, only the items arising after the date of distribution or transfer) are accounted for under the new method of accounting. The definition of cut-off basis is expanded in the final regulations under section 381(c)(5) to clarify that a taxpayer that makes a change within the last-in, first-out (LIFO) inventory method from one LIFO method or sub-method to another LIFO method or sub-method does not recompute the cost of its beginning inventories for the year of change under the new LIFO inventory method when it implements the change on a cut-off basis.

The final regulations under section 381(c)(5) also make certain organizational changes to §1.381(c)(5)-1(e)(6) of the notice of proposed rulemaking with respect to the integration of inventories after a section 381(a) transaction. These changes do not change the substantive rules in the notice of proposed rulemaking but are intended to clarify that the rules apply whether the inventory method of either the acquiring corporation or the transferor or distributor corporation must be changed to a principal method. The IRS and the Treasury Department are considering issuing additional guidance that would clarify or modify the manner in which inventories must be combined and integrated in a section 381(a) transaction.

Finally, the final regulations correct the discussion of section 472(d) that was in §1.381(c)(5)-1(e)(6)(ii)(B) of the notice of proposed rulemaking. Section 1.381(c)(5)-1(e)(6)(ii)(B) of the notice of proposed rulemaking provided that the restoration to cost of any previous write-downs to market value shall be taken into account fully in the year that included

the date of distribution or transfer. Consistent with the amendments to section 472(d), the final regulations provide that these restorations shall be taken into account by the acquiring corporation ratably in each of the three taxable years beginning with the taxable year that includes the date of the distribution or transfer.

The IRS and the Treasury Department are aware that some practitioners were concerned that the notice of proposed rulemaking did not provide audit protection when an acquiring corporation uses a principal method after the date of distribution or transfer. For the reasons expressed in the preamble to the notice of proposed rulemaking, the final regulations continue to deny audit protection in these circumstances. Unlike changes in method of accounting under section 446(e) for which a taxpayer must disclose its use of a method of accounting, proper or improper, as part of the process for obtaining consent to make the change, changes to a principal method pursuant to these final regulations are made on the acquiring corporation's tax return with no disclosure on a Form 3115, "Application for Change in Accounting Method," that a change in method of accounting occurred.

The IRS and the Treasury Department are aware that some taxpayers desire to obtain audit protection for a required change to a principal method by filing a Form 3115. However, the IRS and the Treasury Department believe that, given the need for efficient tax administration, filing a Form 3115 merely to obtain audit protection should not be allowed. Although audit protection is not provided for a change to a principal method required under these regulations, audit protection ordinarily is provided for any voluntary change in method of accounting for which a party to a section 381(a) transaction obtains consent under section 446(e) and the generally applicable administrative procedures.

### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. There-

fore, a regulatory flexibility analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. This certification is based on the belief of the IRS and the Treasury Department that the corporate reorganizations and tax-free liquidations described in section 381(a) generally involve large entities. In addition, these final regulations reduce the burden on taxpayers by clarifying and simplifying the existing rules and make the procedures for requesting changes in methods of accounting relating to corporate reorganizations and tax-free liquidations described in section 381(a) consistent with the general rules for requesting changes in methods of accounting. Pursuant to section 7805(f), the notice of proposed rulemaking that preceded these final regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. Consistent with 5 U.S.C. section 553(d), the regulations are effective 30 days after publication of this document in the **Federal Register**.

### Drafting Information

The principal author of these final regulations is Cheryl Oseekey, Office of Associate Chief Counsel (Income Tax and Accounting). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

### Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

#### PART 1—INCOME TAXES

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

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

Section 1.381(c)(4)–1 also issued under 26 U.S.C. 381(c)(4). \* \* \*

Section 1.381(c)(5)–1 also issued under 26 U.S.C. 381(c)(5). \* \* \*

Par. 2. In §1.381(a)–1, paragraph (b)(1)(i) is revised and paragraph (e) is added to read as follows:

§1.381(a)–1 *General rule relating to carryovers in certain corporate acquisitions.*

\* \* \* \* \*

(b) \* \* \*

(1) \* \* \* (i) The complete liquidation of a subsidiary corporation upon which no gain or loss is recognized in accordance with the provisions of section 332;

\* \* \* \* \*

(e) *Effective/applicability date.* The rules of paragraph (b)(1)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Par. 3. Section 1.381(c)(4)–1 is revised to read as follows:

§1.381(c)(4)–1 *Method of accounting.*

(a) *Introduction—(1) Purpose.* This section provides guidance regarding the method of accounting or combination of methods (other than inventory and depreciation methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(4) apply and how to implement any associated change in method of accounting. See §1.381(c)(5)–1 for guidance regarding the inventory method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(5) apply. See §1.381(c)(6)–1 for guidance regarding the depreciation method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(6) apply.

(2) *Carryover method requirement for separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation continues to operate a trade or business of the parties to the section 381(a) transaction as a separate and distinct trade or business after the date of distribution or transfer, the acquiring corporation must use a carryover method as defined in paragraph (b)(5) of this section for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the carryover method in accordance with paragraph (a)(5) of this section. The carryover method requirement applies to the

overall method of accounting (for example, an accrual method of accounting) and any special method of accounting (for example, the percentage of completion method of accounting described in section 460) as defined in paragraph (b)(2) of this section used by each trade or business after the date of distribution or transfer. The acquiring corporation need not secure the Commissioner's consent to continue a carryover method.

(3) *Principal method requirement for trades or businesses not operated as separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation must use a principal method determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section. The principal method requirement applies to the overall method of accounting (for example, the cash receipts and disbursements method of accounting) and any special method of accounting (for example, the installment method under section 453) as defined in paragraph (b)(2) of this section used by each integrated trade or business after the date of distribution or transfer. The acquiring corporation must change to a principal method in accordance with paragraph (d)(1) of this section for each integrated trade or business and need not secure the Commissioner's consent to use a principal method.

(4) *Carryover method or principal method not a permissible method.* If a carryover method or principal method is not a permissible method of accounting, the acquiring corporation must secure the Commissioner's consent to change to a permissible method of accounting as provided in paragraph (d)(2) of this section. If the acquiring corporation must use a single method of accounting for a particular item after the date of distribution or transfer regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation must

use the principal method for that item as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under this paragraph (a)(4) or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section.

(5) *Voluntary change.* Any party to a section 381(a) transaction may request permission under section 446(e) to change a method of accounting for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate and distinct trades or businesses after the date of distribution or transfer, a change in method of accounting for the taxable year that includes that date will be granted only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The time and manner of obtaining the Commissioner's consent to change to a different method of accounting is described in paragraph (d)(2) of this section.

(6) *Examples.* The following examples illustrate the rules of this paragraph (a). Unless otherwise noted, the carryover method is a permissible method of accounting.

*Example (1). Carryover method for separate and distinct trades or businesses after the date of distribution or transfer—(i) Facts.* X Corporation operates an employment agency that uses the overall cash receipts and disbursements method of accounting. T Corporation operates an educational institution that uses an overall accrual method of accounting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the employment agency as a trade or business that is separate and distinct from the educational institution.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the employment agency as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use the carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the employment agency is the cash receipts and disbursements method of accounting and the carryover method for the educational institution is the accrual method of accounting used by T Corporation immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use either carryover method.

*Example (2). Carryover method for a special method of accounting—(i) Facts.* X Corporation provides personal grooming consulting and T Corporation provides weight management consulting. Both X Corporation and T Corporation use the same overall accrual method of accounting. X Corporation has elected to use the recurring item exception under §1.461-5. T Corporation does not use the recurring item exception. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the personal grooming consulting business as a trade or business that is separate and distinct from the weight management consulting business.

(ii) *Conclusion.* Because after the date of distribution or transfer, X Corporation operates the personal grooming consulting business as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use a carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the overall method of accounting for each trade or business is the accrual method used immediately prior to the date of distribution or transfer. The carryover method for the special method of accounting for the personal grooming consulting business is the recurring item exception under §1.461-5 while the carryover method for the weight management consulting business is not to use the recurring item exception under §1.461-5. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use the carryover methods of accounting.

*Example (3). Carryover method for a special method of accounting not permissible—(i) Facts.* X Corporation is an engineering firm that uses the overall cash receipts and disbursements method of accounting and has elected under section 171 to amortize bond premium with respect to its taxable bonds acquired at a premium. T Corporation is a manufacturer that uses an overall accrual method of accounting and has not made a section 171 election to amortize bond premium with respect to its taxable bonds acquired at a premium. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the engineering firm as a trade or business that is separate and distinct from the manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the engineering firm as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use a carryover method for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover method in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(5) of this section, the carryover method for the overall method of accounting for the engineering firm is the cash receipts and disbursements method used by X Corporation immediately prior to the date of distribution or transfer, and the carryover method

for the overall method of accounting for the manufacturing business is the accrual method used by T Corporation immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use either carryover method. Notwithstanding that after the date of distribution or transfer X Corporation has two separate and distinct trades or businesses, X Corporation is permitted only one method of accounting for amortizable bond premium under section 171. Because after the date of distribution or transfer X Corporation must use a single method of accounting for bond premium for all trades or businesses, X Corporation must use the principal method for that item as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes that method in accordance with paragraph (a)(5) of this section. X Corporation must change to the principal method in accordance with paragraph (d)(1) of this section. If amortizing bond premium is not the principal method, X Corporation may make an election to amortize bond premium to the extent permitted by section 171. See paragraph (e)(2) of this section for rules on making elections.

(b) *Definitions.* For purposes of this section—

(1) *Method of accounting.* A method of accounting has the same meaning as provided in section 446 and any applicable Income Tax Regulations.

(2) *Special method of accounting.* A special method of accounting is a method expressly permitted or required by the Internal Revenue Code, Income Tax Regulations, or administrative guidance published in the Internal Revenue Bulletin that deviates from the normal application of the cash receipts and disbursements method or an accrual method of accounting. The installment method under section 453, the mark-to-market method under section 475, the amortization of bond premium under section 171, the percentage of completion method under section 460, the recurring item exception of §1.461-5, and the income deferral methods under section 455 and §1.451-5 are examples of special methods of accounting. See §1.446-1(c)(1)(iii).

(3) *Adoption of a method of accounting.* Adoption of a method of accounting has the same meaning as provided in §1.446-1(e)(1).

(4) *Change in method of accounting.* A change in method of accounting has the same meaning as provided in §1.446-1(e)(2).

(5) *Carryover method.* A carryover method for the overall method of accounting is the overall method of accounting that

each party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer. The carryover method for a special method of accounting for an item is the special method of accounting for that item that each party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer.

(6) *Principal method.* A principal method is an overall or special method of accounting that is determined under paragraph (c) of this section.

(7) *Permissible method of accounting.* A permissible method of accounting is a method of accounting that is proper or permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(8) *Acquiring corporation.* An acquiring corporation has the same meaning as provided in §1.381(a)-1(b)(2).

(9) *Distributor corporation.* A distributor corporation means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(10) *Transferor corporation.* A transferor corporation means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (a)(1)(C), or (a)(1)(F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (a)(1)(G), provided the requirements of section 354(b) are met.

(11) *Parties to the section 381(a) transaction.* Parties to the section 381(a) transaction means the acquiring corporation and the distributor or transferor corporation that participate in a transaction to which section 381(a) applies.

(12) *Date of distribution or transfer.* The date of distribution or transfer has the same meaning as provided in section 381(b)(2) and §1.381(b)-1(b).

(13) *Separate and distinct trades or businesses.* Separate and distinct trades or businesses has the same meaning as provided in §1.446-1(d).

(14) *Gross receipts.* Gross receipts means all the receipts, including amounts that are excludible from gross income, that must be taken into account under the method of accounting used in a representative period (determined without regard to this section) for federal income tax purposes. For example, gross receipts includes income from investments, amounts received for services, rents, total sales (net of returns and allowances), and both taxable and tax-exempt interest. See paragraph (e)(5) of this section for rules on determining the representative period.

(15) *Audit protection.* Audit protection means, for purposes of paragraph (d)(1) of this section, that the IRS will not require an acquiring corporation that is required to change a method of accounting under paragraph (a)(3) of this section to change that method for a taxable year ending prior to the taxable year that includes the date of distribution or transfer.

(16) *Section 481(a) adjustment.* The section 481(a) adjustment means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of an acquiring corporation is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

(17) *Cut-off basis.* A cut-off basis means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made under paragraph (d)(1) of this section, after the date of distribution or transfer) are accounted for under the new method of accounting.

(18) *Adjustment period.* The adjustment period means the number of taxable years for taking into account the section 481(a) adjustment required as a result of a change in method of accounting.

(19) *Component trade or business.* A component trade or business is a trade or business of a party to the section 381(a) transaction that will be combined and integrated with a trade or business of the other party to the section 381 transaction. See paragraph (e)(4)(ii) of this section for the determination of whether a trade or business is operated as a separate and distinct

trade or business after the date of distribution or transfer.

(c) *Principal method*—(1) *In general.* For each integrated trade or business, the principal method is generally the method of accounting used by the component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer. If, however, the component trade or business of the distributor or transferor corporation is larger than the component trade or business of the acquiring corporation on the date of distribution or transfer, the principal method is the method used by the component trade or business of the distributor or transferor corporation immediately prior to that date. If the larger component trade or business does not have a special method of accounting for a particular item immediately prior to the date of distribution or transfer, the principal method for that item is the method of accounting used by the component trade or business that does have a special method of accounting for that item. See paragraph (e)(9) of this section for special rules concerning methods of accounting that are elected on a project-by-project, job-by-job, or other similar basis. For each integrated trade or business, the component trade or business of the distributor or transferor corporation is larger than the component trade or business of the acquiring corporation on the date of distribution or transfer if—

(i) The aggregate of the adjusted bases of the assets held by each component trade or business of the distributor or transferor corporation (determined under section 1011 and any applicable Income Tax Regulations) exceeds the aggregate of the adjusted bases of the assets of each component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer, and

(ii) The aggregate of the gross receipts for a representative period of each component trade or business of the distributor or transferor corporation exceeds the aggregate of the gross receipts for the same period of each component trade or business of the acquiring corporation. See paragraph (e)(5) of this section for rules on determining the representative period.

(2) *Multiple component trades or businesses with different principal methods.* If a party to the section 381(a) transaction has multiple component trades or busi-

nesses and more than one principal overall method of accounting or more than one principal special method of accounting for an item, then the acquiring corporation may choose which of the principal methods of accounting used by such component trades or businesses will be the principal methods of the integrated trade or business. The acquiring corporation must choose a principal method that is a permissible method of accounting. In general, a change to a principal method in a transaction to which section 381(a) and paragraph (a)(3) of this section applies is made under paragraph (d)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of this paragraph (c). Unless otherwise noted, the principal method is a permissible method of accounting.

*Example (1). Principal method is the method used by the acquiring corporation*—(i) *Facts.* X Corporation and T Corporation each operate an employment agency. X Corporation uses the overall cash receipts and disbursements method of accounting, and T Corporation uses an overall accrual method of accounting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. The adjusted bases of the assets in X Corporation's employment agency immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's employment agency, and the gross receipts in X Corporation's employment agency for the representative period exceed the gross receipts of T Corporation's employment agency for the period. After the date of distribution or transfer, X Corporation's employment agency will not be operated as a trade or business that is separate and distinct from T Corporation's employment agency.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its employment agency as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. Because on the date of distribution or transfer T Corporation's employment agency is not larger than X Corporation's employment agency, the principal method for the overall method of accounting is the cash receipts and disbursements method used by X Corporation's employment agency. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency acquired from T Corporation to the cash receipts and disbursements method.

*Example (2). Principal method is the method used by the acquiring corporation*—(i) *Facts.* The facts are the same as in *Example (1)*, except that the gross receipts of T Corporation's employment agency

for the representative period exceed the gross receipts of X Corporation's employment agency for the period.

(ii) *Conclusion.* The result is the same as in *Example (1)*. Although the gross receipts of T Corporation's employment agency exceed the gross receipts of X Corporation's employment agency, T Corporation's employment agency is not larger than X Corporation's employment agency because the adjusted bases of the assets of T Corporation's employment agency do not exceed the adjusted bases of the assets of X Corporation's employment agency. Thus, the principal method for the overall method of accounting is the cash receipts and disbursements method of accounting used by X Corporation's employment agency immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency business acquired from T Corporation to the cash receipts and disbursements method.

*Example (3). Principal method is the method used by the distributor or transferor corporation*—(i) *Facts.* The facts are the same as in *Example (2)*, except that the adjusted bases of the assets held by T Corporation's employment agency immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets held by X Corporation's employment agency.

(ii) *Conclusion.* The principal method for the overall method of accounting is the accrual method of accounting used by T Corporation's employment agency immediately prior to the date of distribution or transfer because on the date of distribution or transfer T Corporation's employment agency is larger than X Corporation's employment agency. The adjusted bases of the assets of T Corporation's employment agency exceed the adjusted bases of the assets of X Corporation's employment agency, and the gross receipts of T Corporation's employment agency exceed the gross receipts of X Corporation's employment agency. X Corporation need not secure the Commissioner's consent to use this method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for the employment agency business it operated prior to the date of distribution or transfer to the accrual method of accounting used by T Corporation's employment agency immediately prior to the date of distribution or transfer.

*Example (4). Impermissible principal method*—(i) *Facts.* The facts are the same as in *Example (1)*, except that X Corporation is prohibited under section 448 from using the cash receipts and disbursements method of accounting after the date of distribution or transfer.

(ii) *Conclusion.* Because section 448 prohibits X Corporation from using the cash receipts and disbursements method of accounting, X Corporation is not permitted to use the principal method for the overall method of accounting as determined in *Example (1)*. Because after the date of distribution or transfer that method is not a permissible method, under paragraph (a)(4) of this section X Corporation must secure the Commissioner's consent to change to a permissible method in accordance with the procedures set forth in paragraph (d)(2) of this section.

*Example (5). Voluntary change not allowable—(i) Facts.* The facts are the same as in *Example (4)*, except that T Corporation wants to discontinue using the overall accrual method of accounting for its employment agency and change to the cash receipts and disbursements method for the taxable year in which the section 381(a) transaction occurs or is expected to occur.

(ii) *Conclusion.* Under paragraph (a)(5) of this section, the Commissioner will grant a request to change a method of accounting for the taxable year that includes the date of distribution or transfer only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The Commissioner will not consent to a request by T Corporation to change to the cash receipts and disbursements method for the taxable year in which the section 381(a) transaction occurs or is expected to occur because X Corporation cannot use the cash receipts and disbursements method after the date of distribution or transfer.

*Example (6). Principal methods are the acquiring corporation's methods—(i) Facts.* X Corporation and T Corporation each publishes magazines. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. Both X Corporation and T Corporation use an overall accrual method of accounting. X Corporation has elected to defer income from its subscription sales under section 455. T Corporation has not elected to defer income from its subscription sales under section 455 and instead has recognized the income from these sales in accordance with section 451. The adjusted bases of the assets in X Corporation's publication business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's publication business, and the gross receipts in X Corporation's publication business for the representative period exceed the gross receipts in T Corporation's publication business for the representative period. After the date of distribution or transfer, X Corporation will not operate its publication business as a trade or business that is separate and distinct from T Corporation's publication business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its publication business as a separate and distinct trade or business, X Corporation must use the principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. The adjusted bases of the assets in T Corporation's publication business do not exceed the adjusted bases of the assets in X Corporation's publication business, and the gross receipts in T Corporation's publication business do not exceed the gross receipts in X Corporation's publication business. Because on the date of distribution or transfer T Corporation's publication business is not larger than X Corporation's publication business, the principal method for the overall method of accounting is the accrual method used by X Corporation's publication business immediately prior to the date of distribution or transfer. The principal method for subscription sales is the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to

use the principal method for either the overall method of accounting or the special method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change both the overall method of accounting and the special method of accounting for the publication business acquired from T Corporation to the accrual method and the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer.

*Example (7). Principal methods are the acquiring corporation's methods—(i) Facts.* The facts are the same as in *Example (6)*, except that the adjusted bases of the assets in T Corporation's publication business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in X Corporation's business.

(ii) *Conclusion.* The result is the same as in *Example (6)*. Because on the date of distribution or transfer T Corporation's publication business is not larger than X Corporation's publication business, the principal method for the overall method of accounting is the accrual method used by X Corporation's publication business immediately prior to the date of distribution or transfer. The principal method for subscription sales is the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for either the overall method of accounting or the special method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change both the overall method of accounting and the special method of accounting for the publication business acquired from T Corporation to the accrual method and the section 455 deferral method used by X Corporation immediately prior to the date of distribution or transfer.

*Example (8). Principal method determination when larger component trade or business does not have a special method of accounting—(i) Facts.* X Corporation and T Corporation both install ice skating rinks. Both X Corporation and T Corporation use an overall accrual method of accounting for their respective businesses. X Corporation completes its installation contracts within the contracting year and uses an accrual method of accounting to recognize the revenue from its installation contracts. T Corporation's installation contracts are subject to section 460, and T Corporation recognizes the revenue from such contracts under the percentage-of-completion method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. The adjusted bases of the assets in X Corporation's installation business immediately prior to the date of distribution or transfer exceed the adjusted bases of the assets in T Corporation's installation business, and the gross receipts in X Corporation's installation business for the representative period exceed the gross receipts in T Corporation's installation business for the representative period. After the date of distribution or transfer, X Corporation will not operate its installation business as a trade or business that is separate and distinct from T Corporation's installation business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its installation business as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either

the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. The adjusted bases of the assets in T Corporation's installation business do not exceed the adjusted bases of the assets in X Corporation's installation business, and the gross receipts in T Corporation's installation business do not exceed the gross receipts in X Corporation's installation business. Because on the date of distribution or transfer T Corporation's installation business is not larger than X Corporation's installation business, the principal method for the overall method of accounting is the accrual method used by X Corporation's installation business immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for the overall method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the overall method of accounting for the installation business acquired from T Corporation to the accrual method used by X Corporation. Under paragraph (c) of this section, the principal method for T Corporation's long-term contracts is the percentage-of-completion method used by T Corporation immediately prior to the date of distribution or transfer because X Corporation's installation business does not have a method of accounting for long-term contracts. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use T Corporation's percentage-of-completion method.

*Example (9). Principal method determination with a combined trade or business and a separate and distinct trade or business—(i) Facts.* X Corporation operates a tennis academy as a trade or business that is separate and distinct from its trade or business of operating a golf academy. X Corporation uses the overall cash receipts and disbursements method of accounting for the tennis academy and an overall accrual method of accounting for the golf academy. T Corporation operates a tennis academy and uses an accrual method of accounting for the overall method. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation will not operate its tennis academy as a trade or business that is separate and distinct from T Corporation's tennis academy. X Corporation will continue to operate its golf academy as a trade or business that is separate and distinct from the operation of the tennis academy. The adjusted bases of the assets in T Corporation's tennis academy exceed the adjusted bases of the assets in X Corporation's tennis academy immediately prior to the date of distribution or transfer. The gross receipts of T Corporation's tennis academy for the representative period exceed the gross receipts of X Corporation's tennis academy for that period.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its tennis academy as a separate and distinct trade or business, X Corporation must use a principal method under paragraph (a)(3) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal method in accordance with paragraph (a)(5) of this section. Because

on the date of distribution or transfer the tennis academy operated by T Corporation is larger than the tennis academy operated by X Corporation, the principal method for the overall method of accounting for the combined tennis academy business is the accrual method used by T Corporation's tennis academy immediately prior to the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal method for the overall method of accounting. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the method of accounting for its tennis academy to the accrual method. Because X Corporation will operate the golf academy as a separate trade or business, under paragraph (a)(2) of this section X Corporation must continue to use the accrual method that it used immediately prior to the date of distribution or transfer as the carryover method for the golf academy. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use the carryover method.

*Example (10). Principal method determination with multiple component trades or businesses—(i) Facts.* The facts are the same as in *Example (9)*, except that after the date of distribution or transfer X Corporation will not operate its golf academy as a trade or business that is separate and distinct from the tennis academy. In addition, X Corporation's component trades or businesses are larger than T Corporation's component trade or business: (1) the adjusted bases of the assets of X Corporation's tennis academy and golf academy businesses, in the aggregate, exceed the adjusted bases of the assets held by T Corporation's tennis academy; and (2) the gross receipts for the representative period of X Corporation's tennis academy and golf academy businesses, in the aggregate, exceed the gross receipts in T Corporation's tennis academy.

(ii) *Conclusion.* Because on the date of distribution or transfer T Corporation's tennis academy is not larger than X Corporation's combined tennis academy and golf academy, the principal method for the overall method of accounting is the method of accounting used by the component trades or businesses of X Corporation that will be combined with T Corporation's component trade or business on that date. Because on the date of distribution or transfer X Corporation operates two component trades or businesses with different overall methods of accounting that will be integrated after the date of distribution or transfer, X Corporation may choose under paragraph (c)(2) of this section which overall method (and any special method of accounting) used by its component trades or businesses will be the principal method. X Corporation may choose to use either the accrual method used by the golf academy or the cash receipts and disbursements method used by its tennis academy as the principal method after the date of distribution or transfer, if either method is a permissible method. In accordance with paragraph (d)(1) of this section, X Corporation must change T Corporation's overall method of accounting to the principal method. Under paragraph (a)(3) of this section, X Corporation also must change either its golf academy business or its tennis academy business, depending on which principal method X Corporation selects, to the principal method.

(d) *Procedures for changing a method of accounting—(1) Change made to prin-*

*cipal method under paragraph (a)(3) of this section—(i) Section 481(a) adjustment—(A) In general.* An acquiring corporation that changes its method of accounting or the distributor or transferor corporation's method of accounting under paragraph (a)(3) of this section does not need to secure the Commissioner's consent to use the principal method. To the extent the use of a principal method constitutes a change in method of accounting, the change in method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method, whether the change relates to a trade or business of the acquiring corporation or a trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement a change to the principal method are determined under §1.446-1(e) and the applicable administrative procedures that govern voluntary changes in methods of accounting under section 446(e). If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require that a method of accounting be implemented on a cut-off basis, the acquiring corporation must implement the change on a cut-off basis as of the date of distribution or transfer on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the date of distribution or transfer.

(B) *Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

*Example.* X Corporation uses the overall cash receipts and disbursements method of accounting, and T Corporation uses an overall accrual method of ac-

counting. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation determines that under the rules of paragraph (c)(1) of this section X Corporation must change the method of accounting for the business acquired from T Corporation to the cash receipts and disbursements method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the cash receipts and disbursements method by consolidating the adjustments (whether the amounts thereof represent increases or decreases in items of income or deductions) arising with respect to balances in the various accounts, such as accounts receivable, as of the beginning of the day that immediately follows the day on which X Corporation acquires the assets of T Corporation. X Corporation will reflect this adjustment, or an appropriate part thereof, on its federal income tax return for the taxable year that includes the date of distribution or transfer.

(ii) *Audit protection.* Notwithstanding any other provision in any other Income Tax Regulation or administrative procedure, no audit protection is provided for any change in method of accounting under paragraph (d)(1) of this section.

(iii) *Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in §1.446-1(e) and the applicable administrative procedures for voluntary changes in method of accounting under section 446(e) apply to a change in method of accounting under this section. Thus, for example, if the administrative procedures for a particular change in method of accounting have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to a change made under this paragraph (d)(1). However, any scope limitation in the applicable administrative procedures will not apply for purposes of making a change under this paragraph (d)(1). For example, if the administrative procedures provide as a limitation that an identical change in method of accounting is barred for a period of years, this limitation will not bar a change to the principal method made under this section.

(2) *Change made to a method of accounting under paragraph (a)(4) or (a)(5) of this section—(i) In general.* A party to a section 381(a) transaction that changes a method of accounting under either paragraph (a)(4) or paragraph (a)(5) of this section must follow the provisions of §1.446-1(e) and the applicable administrative procedures, including scope limitations, for voluntary changes in method of accounting under section 446(e), except

as provided in paragraphs (d)(2)(ii) and (d)(2)(iii) of this section. An application on Form 3115, "Application for Change in Accounting Method," filed with the IRS to change a method of accounting under this paragraph (d)(2) should be labeled "Filed under section 381(c)(4)" at the top.

(ii) *Final year limitation.* Any scope limitation relating to the final year of a trade or business will not apply to a taxpayer that changes its method of accounting in the final year of a trade or business that is terminated as the result of a section 381(a) transaction.

(iii) *Time to file.* Under the authority of §1.446-1(e)(3)(ii), for a change in method of accounting requiring advance consent, the application for a change in method of accounting (for example, Form 3115) must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in §1.446-1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(1) The day that is 180 days after the date of distribution or transfer, or

(2) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred.

(e) *Rules and procedures*—(1) *No method of accounting.* If a party to a section 381(a) transaction is not using a method of accounting, does not have a method of accounting for a particular item, or came into existence as a result of the transaction, the party will not be treated as having a method of accounting different from that used by another party to the section 381(a) transaction.

(2) *Elections and adoptions allowed.* If an election does not require the Commissioner's consent, an acquiring corporation or a distributor or transferor corporation is not precluded from making any election that is otherwise permissible for the taxable year that includes the date of distribution or transfer. For purposes of this section, a corporation shall be deemed as having made any election as of the first day of the taxable year that includes the date of distribution or transfer. Similarly, where adoption is permissible, an acquiring corporation or a distributor or transferor corporation may adopt any permissible method of accounting for the taxable

year that includes the date of distribution or transfer.

(3) *Elections continue after section 381(a) transaction*—(i) *General rule.* An acquiring corporation is not required to renew any election not otherwise requiring renewal and previously made by it or by a distributor or transferor corporation for a carryover method or a principal method if the acquiring corporation uses the method after the section 381(a) transaction. If the acquiring corporation uses a method after the date of distribution or transfer, an election made by the acquiring corporation or by a distributor or transferor corporation for that method that was in effect on the date of distribution or transfer continues after the section 381(a) transaction as though the distribution or transfer had not occurred.

(ii) *Example.* The following example illustrates the rules of this paragraph (e)(3):

*Example.* The acquiring corporation, X Corporation, previously elected to amortize bond premium under section 171. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. X Corporation determines under the rules of paragraph (c)(1) of this section that X Corporation's method of amortizing bond premium is the principal method. After the date of distribution or transfer, X Corporation is not required to renew its bond premium amortization election and is bound by it. Additionally, X Corporation would not be required to renew its election to amortize bond premium if the method were the carryover method under paragraph (a)(2) of this section.

(4) *Appropriate times for certain determinations*—(i) *Determining the method of accounting.* The method of accounting used by a party to a section 381(a) transaction on the date of distribution or transfer is the method of accounting used by that party as of the end of the day that is immediately prior to the date of distribution or transfer.

(ii) *Determining whether there are separate and distinct trades or businesses after the date of distribution or transfer.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer will be determined as of the date of distribution or transfer based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring

corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year that includes the date of distribution or transfer.

(5) *Representative period for aggregating gross receipts.* The representative period for measuring gross receipts is generally the 12 consecutive months preceding the date of distribution or transfer. If a component trade or business was not in existence for the 12 consecutive months preceding the date of distribution or transfer, then all component trades or businesses of each integrated trade or business will compare their gross receipts for the period that such trade or business was in existence. For example, if the acquiring corporation's component trade or business was formed in August and the date of distribution or transfer occurred in December of the same year, the gross receipts for those five months will be compared with the gross receipts of the other component trades or businesses for the same period.

(6) *Establishing a method of accounting.* A method of accounting used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation after the date of distribution or transfer is an established method of accounting for purposes of section 446(e), whether or not such method is proper or is permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(7) *Other applicable provisions.* This section does not preempt any other provision of the Internal Revenue Code or the Income Tax Regulations that is applicable to the acquiring corporation's circumstances. For example, income, deductions, credits, allowances, and exclusions may be allocated among the parties to a section 381(a) transaction and other taxpayers under sections 269 and 482, if appropriate. Similarly, transfers of contracts accounted for using a long-term contract method of accounting are governed by the rules provided in §1.460-4(k). Further, if other paragraphs of section 381(c) apply for purposes of determining the methods of accounting to be used following the date of distribution or transfer, section 381(c)(4) and this §1.381(c)(4)-1 will not apply to the tax treatment of the items. For example, this section does not apply to

inventories that an acquiring corporation obtains in a transaction to which section 381(a) applies. Instead, the rules of section 381(c)(5) govern the inventory method to be used by the acquiring corporation after the distribution or transfer. Similarly, if the acquiring corporation assumes an obligation of the distributor or transferor corporation that gives rise to a liability after the date of distribution or transfer and to which §1.381(c)(16)-1 applies, the deductibility of the item is determined under this section only after the rules of section 381(c)(16) are applied.

(8) *Character of items of income and deduction.* After the date of distribution or transfer, items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(9) *Method of accounting selected by project or job.* If other sections of the Internal Revenue Code, Income Tax Regulations, or other administrative guidance permit an acquiring corporation to elect a method of accounting on a project-by-project, job-by-job, or other similar basis, then for purposes of this section the method elected with respect to each project or job is the established method only for that project or job. For example, the election under section 460 to classify a contract to perform both manufacturing and construction activities as a long-term construction contract if at least 95 percent of the estimated total allocable contract costs are reasonably allocated to the construction activities is made on a contract-by-contract basis. Accordingly, the method of accounting previously elected for a project or job generally continues after the date of distribution or transfer. However, if the trades or businesses of the parties to a section 381(a) transaction are not operated as separate and distinct trades or businesses after the date of distribution or transfer, and two or more of the parties to the section 381(a) transaction previously worked on the same project or job and used different methods of accounting for the project or job immediately before the distribution or transfer, then the acquiring corporation must determine the principal method for that project or job under paragraph (c) of this section and make changes, if neces-

sary, to the principal method in accordance with paragraph (d)(1) of this section.

(10) *Impermissible method of accounting.* This section does not limit the Commissioner's ability under section 446(b) to determine whether a taxpayer's method of accounting is an impermissible method or otherwise fails to clearly reflect income. For example, an acquiring corporation may not use the method of accounting determined under paragraph (a)(2) of this section if the method fails to clearly reflect the acquiring corporation's income within the meaning of section 446(b).

(f) *Effective/applicability date.* This section applies to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Par. 4. Section 1.381(c)(5)-1 is revised to read as follows:

#### §1.381(c)(5)-1 Inventory method.

(a) *Introduction—(1) Purpose.* This section provides guidance regarding the inventory method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(5) apply and how to implement any associated change in method of accounting. See §1.381(c)(4)-1 for guidance regarding the method of accounting or combination of methods (other than inventory and depreciation methods) an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(4) apply. See §1.381(c)(6)-1 for guidance regarding the depreciation method an acquiring corporation must use following a distribution or transfer to which sections 381(a) and 381(c)(6) apply.

(2) *Carryover method requirement for separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation continues to operate a trade or business of the parties to the section 381(a) transaction as a separate and distinct trade or business after the date of distribution or transfer, the acquiring corporation must use a carryover method as defined in paragraph (b)(4) of this section for each continuing trade or business, unless either the carryover method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the carryover method in accordance with

paragraph (a)(5) of this section. The acquiring corporation need not secure the Commissioner's consent to continue a carryover method.

(3) *Principal method requirement for trades or businesses not operated as separate and distinct trades or businesses.* In a transaction to which section 381(a) applies, if an acquiring corporation does not operate the trades or businesses of the parties to the section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer, the acquiring corporation must use a principal method determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under paragraph (a)(4) of this section or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section. The acquiring corporation must change to a principal method in accordance with paragraph (d)(1) of this section for each integrated trade or business and need not secure the Commissioner's consent to use a principal method.

(4) *Carryover method or principal method not a permissible method.* If a carryover method or principal method is not a permissible inventory method, the acquiring corporation must secure the Commissioner's consent to change to a permissible inventory method as provided in paragraph (d)(2) of this section. If the acquiring corporation must use a single inventory method for a particular type of goods after the date of distribution or transfer regardless of the number of separate and distinct trades or businesses operated on that date, the acquiring corporation must use the principal method for that type of goods as determined under paragraph (c) of this section, unless either the principal method is impermissible and must be changed under this paragraph (a)(4) or the acquiring corporation changes the principal method in accordance with paragraph (a)(5) of this section.

(5) *Voluntary change.* Any party to a section 381(a) transaction may request permission under section 446(e) to change an inventory method for the taxable year in which the transaction occurs or is expected to occur. For trades or businesses that will not operate as separate and distinct trades or businesses after the date of distribution or transfer, a change in method of account-

ing for the taxable year that includes that date will be granted only if the requested inventory method is the method that the acquiring corporation must use after the date of distribution or transfer. The time and manner of obtaining the Commissioner's consent to change to a different inventory method is described in paragraph (d)(2) of this section.

(6) *Examples.* The following examples illustrate the rules of this paragraph (a). Unless otherwise noted, the carryover method is a permissible inventory method.

*Example (1). Carryover method for separate and distinct trades or businesses after the date of distribution or transfer—(i) Facts.* X Corporation manufactures radios and television sets. X Corporation uses the first-in, first-out (FIFO) method of inventory identification, the cost method of valuing its inventories, and capitalizes inventory costs in accordance with section 263A. T Corporation manufactures washing machines and dryers. T Corporation uses the last-in, first-out (LIFO) method of inventory identification, the cost method of valuing its inventories, and capitalizes inventory costs under section 263A using methods other than those used by X Corporation. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates its radio and television manufacturing business as a trade or business that is separate and distinct from its washing machines and dryers manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates its manufacturing businesses as separate and distinct trades or businesses, under paragraph (a)(2) of this section X Corporation must use the carryover methods for each continuing trade or business, unless either the carryover methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover methods in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(4) of this section, the carryover methods for the radios and television sets manufacturing business are the FIFO method, the cost basis of valuation, and X Corporation's methods of accounting for section 263A costs immediately prior to the date of distribution or transfer. The carryover methods for the washing machines and dryers manufacturing business are the LIFO method, the cost basis of valuation, and T Corporation's methods of accounting for section 263A costs immediately prior to the date of distribution or transfer. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use any carryover method.

*Example (2). Carryover method not permissible—(i) Facts.* X Corporation manufactures food and beverages and uses the FIFO method of inventory identification, the cost method of valuing its inventories, and capitalizes costs in accordance with section 263A. T Corporation sells sporting equipment. T Corporation uses the FIFO method of inventory identification and the cost method of valuing its inventories. T Corporation does not capitalize costs under section 263A because it meets the small re-

seller exception under section 263A. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. After the date of distribution or transfer, X Corporation operates the food and beverages business as a trade or business that is separate and distinct from the sporting equipment business, and X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation operates the food and beverages business as a separate and distinct trade or business, under paragraph (a)(2) of this section X Corporation must use the carryover methods for each continuing trade or business, unless either the carryover methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the carryover methods in accordance with paragraph (a)(5) of this section. As defined in paragraph (b)(4) of this section, the carryover methods for the food and beverages business are the FIFO method, the cost basis of valuation, and X Corporation's methods of capitalizing costs under section 263A immediately prior to the date of distribution or transfer. The carryover methods for the sporting equipment business are the FIFO method and the cost basis of valuation. There is no change in method of accounting, and X Corporation need not secure the Commissioner's consent to use any carryover method. However, because X Corporation does not qualify for the small reseller exception under section 263A for its sporting equipment business, X Corporation's method of not capitalizing additional section 263A costs is an impermissible carryover method under paragraph (a)(4) of this section. X Corporation must secure the Commissioner's consent to change to a permissible method of capitalizing costs under section 263A for the sporting equipment business as provided in paragraph (d)(2) of this section.

(b) *Definitions.* For purposes of this section—

(1) *Inventory method.* An inventory method is a method of accounting used to account for merchandise on hand (including finished goods, work in process, and raw materials) at the beginning of a year for purposes of computing taxable income for that year. The term includes not only the method for identifying inventory, for example, the FIFO inventory method or the LIFO inventory method, but also all other methods necessary to account for merchandise.

(2) *Adoption of a method of accounting.* Adoption of a method of accounting has the same meaning as provided in §1.446-1(e)(1).

(3) *Change in method of accounting.* A change in method of accounting has the same meaning as provided in §1.446-1(e)(2).

(4) *Carryover method.* A carryover method is an inventory method that each

party to a section 381(a) transaction uses for each separate and distinct trade or business immediately prior to the date of distribution or transfer.

(5) *Principal method.* A principal method is an inventory method that is determined under paragraph (c) of this section.

(6) *Permissible method of accounting.* A permissible method of accounting is a method of accounting that is proper or permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(7) *Acquiring corporation.* An acquiring corporation has the same meaning as provided in §1.381(a)-1(b)(2).

(8) *Distributor corporation.* A distributor corporation means the corporation, foreign or domestic, that distributes its assets to another corporation described in section 332(b) in a distribution to which section 332 (relating to liquidations of subsidiaries) applies.

(9) *Transferor corporation.* A transferor corporation means the corporation, foreign or domestic, that transfers its assets to another corporation in a transfer to which section 361 (relating to nonrecognition of gain or loss to corporations) applies, but only if—

(i) The transfer is in connection with a reorganization described in section 368(a)(1)(A), (a)(1)(C), or (a)(1)(F), or

(ii) The transfer is in connection with a reorganization described in section 368(a)(1)(D) or (a)(1)(G), provided the requirements of section 354(b) are met.

(10) *Parties to the section 381(a) transaction.* Parties to the section 381(a) transaction means the acquiring corporation and the distributor or transferor corporation that participate in a transaction to which section 381(a) applies.

(11) *Date of distribution or transfer.* The date of distribution or transfer has the same meaning as provided in section 381(b)(2) and §1.381(b)-1(b).

(12) *Separate and distinct trades or businesses.* Separate and distinct trades or businesses has the same meaning as provided in §1.446-1(d).

(13) *Audit protection.* Audit protection means, for purposes of paragraph (d)(1) of this section, that the IRS will not require an acquiring corporation that is required to change a method of accounting under paragraph (a)(3) of this section to change that method for a taxable year ending prior

to the taxable year that includes the date of distribution or transfer.

(14) *Section 481(a) adjustment.* The section 481(a) adjustment means an adjustment that must be taken into account as required under section 481(a) to prevent amounts from being duplicated or omitted when the taxable income of an acquiring corporation is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

(15) *Cut-off basis.* A cut-off basis means a manner in which a change in method of accounting is made without a section 481(a) adjustment and under which only the items arising after the beginning of the year of change (or, in the case of a change made under paragraph (d)(1) of this section, after the date of distribution or transfer) are accounted for under the new method of accounting. When it implements the change on a cut-off basis, a taxpayer using the LIFO inventory method to identify its inventory goods that makes a change in method of accounting within the LIFO inventory method from one LIFO method or sub-method to another LIFO method or sub-method uses the new LIFO inventory method to determine its current-year cost and base-year cost of ending inventories for the year of change, but does not recompute the cost of beginning inventories for the year of change using the new LIFO inventory method.

(16) *Adjustment period.* The adjustment period means the number of taxable years for taking into account the section 481(a) adjustment required as a result of a change in method of accounting.

(17) *Component trade or business.* A component trade or business is a trade or business of a party to the section 381(a) transaction that will be combined and integrated with a trade or business of the other party to the section 381 transaction. See paragraph (e)(7)(ii) of this section for the determination of whether a trade or business is operated as a separate and distinct trade or business after the date of distribution or transfer.

(c) *Principal method—(1) In general.* For each integrated trade or business, the principal method for a particular type of goods is generally the inventory method used by the component trade or business of the acquiring corporation immediately

prior to the date of distribution or transfer for that type of goods. If, however, on the date of distribution or transfer the component trade or business of the distributor or transferor corporation holds more inventory of a type of goods than the component trade or business of the acquiring corporation, the principal method for such goods is the inventory method used by the component trade or business of the distributor or transferor corporation immediately prior to that date. For each integrated trade or business, the component trade or business of the distributor or transferor corporation holds more inventory if, for a particular type of goods, the aggregate of the fair market value of the goods held by each component trade or business of the distributor or transferor corporation exceeds the aggregate of the fair market value of the goods held by each component trade or business of the acquiring corporation immediately prior to the date of distribution or transfer. Alternatively, as a simplifying convention, the acquiring corporation may elect to apply the preceding sentence to the aggregate fair market value of the entire inventories, held by each component trade or business of the acquiring corporation and each component trade or business of the distributor or transferor corporation, that will be integrated after the date of distribution or transfer. If the component trade or business with the larger aggregate fair market value of the entire inventories does not have an inventory method for a particular type of goods immediately prior to the date of distribution or transfer, the principal method for that type of goods is the inventory method used by the component trade or business that does have an inventory method for that type of goods.

(2) *Multiple component trades or businesses with different principal methods.* If a party to the section 381(a) transaction has multiple component trades or businesses and more than one principal inventory method for a particular type of goods, then the acquiring corporation may choose which of the inventory methods used by such component trades or businesses will be the principal method of the integrated trade or business. The acquiring corporation must choose a principal method that is a permissible method of accounting. In general, a change to a principal method in a transaction to which section 381(a) and paragraph (a)(3) of this section apply is

made under paragraph (d)(1) of this section.

(3) *Examples.* The following examples illustrate the rules of this paragraph (c). Unless otherwise noted, the principal method is a permissible inventory method.

*Example (1). Principal methods are the methods used by the acquiring corporation—(i) Facts.* X Corporation and T Corporation each manufacture tennis equipment. X Corporation's manufacturing business uses the FIFO method of inventory identification, the cost method of valuing inventories, and allocates indirect costs to the property produced using the burden rate method provided in §1.263A-1(f)(3)(i). T Corporation's manufacturing business uses the LIFO method of inventory identification, the cost method of valuing its inventories, and allocates indirect costs to the property it produces using the standard cost method provided in §1.263A-1(f)(3)(ii). X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. The fair market value of each particular type of goods held by X Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by T Corporation's manufacturing business on that date. After the date of distribution or transfer, X Corporation will not operate its manufacturing business as a trade or business that is separate and distinct from T Corporation's manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business does not hold more inventory than X Corporation's manufacturing business, the principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs under section 263A using the burden rate method. X Corporation need not secure the Commissioner's consent to use these methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

*Example (2). Principal methods are the methods used by the acquiring corporation—(i) Facts.* The facts are the same as in *Example (1)*, except that the fair market value of each particular type of goods held by X Corporation's manufacturing business immediately prior to the date of distribution or transfer is identical to the fair market value of each particular type of goods held by T Corporation's manufacturing business on that date.

(ii) *Conclusion.* The result is the same as in *Example (1)*. The principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs under section 263A using the burden rate method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

*Example (3). Principal methods are the methods used by the distributor or transferor corporation—(i) Facts.* The facts are the same as in *Example (1)*, except that the fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of each particular type of goods held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer exceeds the fair market value of each particular type of goods held by X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business holds more inventory than X Corporation's manufacturing business, the principal methods are the LIFO method of inventory identification, the cost method of valuation, and T Corporation's method of allocating indirect costs under section 263A using the standard cost method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business operated by X Corporation prior to the date of distribution or transfer to the principal methods.

*Example (4). Voluntary change allowable—(i) Facts.* The facts are the same as in *Example (1)*, except that T Corporation wants to discontinue using the LIFO method for its manufacturing business and change to the FIFO method for the taxable year in which the section 381(a) transaction occurs or is expected to occur.

(ii) *Conclusion.* Under paragraph (a)(5) of this section, the Commissioner will grant a request to change a method of accounting for the taxable year that includes the date of distribution or transfer only if the requested method is the method that the acquiring corporation must use after the date of distribution or transfer. The Commissioner will consent to a request by T Corporation to change to the FIFO method for the taxable year in which the section 381(a) transaction occurs or is expected to occur because X Corporation will use this method after the date of distribution or transfer.

*Example (5). Principal method determination when larger component trade or business does not have a method of accounting for a particular type of goods—(i) Facts.* The facts are the same as in *Example (1)*, except that T Corporation's manufacturing business has a particular type of goods that is not held by X Corporation's manufacturing business.

(ii) *Conclusion.* The result is similar to *Example (1)*. In general, the principal methods are the FIFO method of inventory identification, the cost method of valuation, and X Corporation's method of allocating indirect costs to the property produced using the burden rate method. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods. Under paragraph (c) of this section, the principal methods for the particular type of goods held only by T Corporation's manufacturing business are the LIFO method of inventory identification, the cost method of valuation, and T Corporation's method of allocating indirect costs to the property it produces using the standard cost method. X Corporation must determine whether the principal methods for the type of goods previously held by T Corporation are permissible given that such methods are different than the principal methods that must be used by X for all other goods. If X Corporation's use of the standard cost method would be impermissible after the date of distribution or transfer, X Corporation must change to a permissible method under section 263A for those goods in accordance with paragraph (a)(4) of this section.

*Example (6). Inventory convention elected—(i) Facts.* X Corporation manufactures planes and T Corporation manufactures planes and communications satellites. X Corporation's manufacturing business uses the FIFO method of inventory identification and values its inventories at cost or market, whichever is lower, while T Corporation's manufacturing business uses the LIFO method of inventory identification and values its inventories at cost. X Corporation's manufacturing business and T Corporation's manufacturing business use the same methods to capitalize costs under section 263A. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. In lieu of determining the fair market value of each particular type of goods held on the date of distribution or transfer, X Corporation elects to value the entire inventories of its manufacturing business and the entire inventories of T Corporation's manufacturing business in accordance with paragraph (c)(1) of this section. The fair market value of the inventory held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of the inventory held by X Corporation's manufacturing business on that date. After the date of distribution or transfer, X Corporation will not operate its manufacturing business as a trade or business that is separate and distinct from T Corporation's manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section,

unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. The fair market value of the entire inventory held by T Corporation's manufacturing business immediately prior to the date of distribution or transfer does not exceed the fair market value of the entire inventory of X Corporation's manufacturing business on that date. Because on the date of distribution or transfer T Corporation's manufacturing business does not hold more inventory than X Corporation's manufacturing business, the principal methods are the FIFO method, the cost or market, whichever is lower, method of valuation, and X Corporation's method of capitalizing costs under section 263A on the date of distribution or transfer. X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods for the manufacturing business acquired from T Corporation to the principal methods.

*Example (7). Principal method determination with a combined trade or business and a separate and distinct trade or business—(i) Facts.* X Corporation manufactures tennis equipment in a trade or business that is separate and distinct from its trade or business of manufacturing golf equipment. X Corporation uses the FIFO method of inventory identification for its tennis equipment and the LIFO method of inventory identification for its golf equipment. X Corporation values the goods in both inventories at cost and allocates indirect costs to the property produced using the burden rate method provided in §1.263A-1(f)(3)(i). T Corporation manufactures tennis equipment. T Corporation's manufacturing business uses the FIFO method of inventory identification, values inventories at cost, and allocates indirect costs to the property it produces using the standard cost method provided in §1.263A-1(f)(3)(ii). X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. Immediately prior to the date of distribution or transfer, the fair market value of T Corporation's inventories in the tennis equipment manufacturing business exceeds the fair market value of the inventories held by X Corporation's tennis equipment manufacturing business. After the date of distribution or transfer, X Corporation will not operate its tennis equipment manufacturing business as a trade or business that is separate and distinct from T Corporation's tennis equipment manufacturing business, but X Corporation will operate its golf equipment manufacturing business as a trade or business that is separate and distinct from the tennis equipment manufacturing business.

(ii) *Conclusion.* Because after the date of distribution or transfer X Corporation will not operate its tennis equipment manufacturing business as a separate and distinct trade or business, X Corporation must use the principal methods under paragraph (a)(3) of this section, unless either the principal methods are impermissible and must be changed under paragraph (a)(4) of this section or X Corporation changes the principal methods in accordance with paragraph (a)(5) of this section. Under paragraph (c)(1) of this section, X Corporation elects to compare the fair market values of the entire inventories

of the component trades or businesses on the date of distribution or transfer to determine whether T Corporation holds more inventory than X Corporation. The fair market value of the inventory held by T Corporation's tennis equipment manufacturing business exceeds the fair market value of the tennis equipment held by X Corporation's tennis equipment manufacturing business. Because on the date of distribution or transfer T Corporation's tennis equipment manufacturing business holds more inventory than X Corporation's tennis equipment manufacturing business, the principal methods for the combined tennis equipment business are the FIFO method of inventory identification, the cost basis of valuation, and T Corporation's methods of allocating indirect costs under section 263A using the standard cost method provided in §1.263A-1(f)(3)(ii). X Corporation need not secure the Commissioner's consent to use the principal methods. However, in accordance with paragraph (d)(1) of this section, X Corporation must change the methods of accounting for its tennis equipment manufacturing business to the principal methods. Under paragraph (a)(2) of this section, because X Corporation will operate the golf equipment manufacturing business as a separate trade or business, for the inventories held by the golf equipment manufacturing business X Corporation must continue to use the LIFO method of inventory identification, use the cost basis of valuation, and allocate indirect costs under section 263A using the burden rate method provided in §1.263A-1(f)(3)(i). There are no changes in method of accounting for the golf manufacturing business, and X Corporation need not secure the Commissioner's consent to use these carryover methods.

*Example (8). Principal method determination with multiple component trades or businesses—(i) Facts.* The facts are the same as in *Example (7)*, except that after the date of distribution or transfer X Corporation will not operate the golf equipment manufacturing business as a trade or business that is separate and distinct from the tennis equipment manufacturing business. In addition, the fair market value of the inventories of X Corporation's tennis equipment manufacturing business and golf equipment manufacturing business, in the aggregate, exceed the fair market value of the inventories of T Corporation's tennis equipment manufacturing business.

*(ii) Conclusion.* Because on the date of distribution or transfer T Corporation's tennis equipment manufacturing business does not hold more inventory than X Corporation's tennis equipment manufacturing business and golf equipment manufacturing business, in the aggregate, the principal method for identifying inventory is the method used by X Corporation's component trade or business on the date of distribution or transfer. However, because on the date of distribution or transfer X Corporation operates two separate and distinct trades or businesses with different inventory identification methods that will be combined after the date of distribution or transfer, X Corporation may choose under paragraph (c)(2) of this section which method used by its component trades or businesses will be the principal method. After the date of distribution or transfer, X Corporation may use either the FIFO method of inventory identification used by the tennis equipment manufacturing business or the LIFO method of inventory identifica-

tion used by the golf equipment manufacturing business as the principal method of identification, if either method is a permissible method. For the integrated trade or business, X Corporation will use the cost method of valuation and allocate indirect costs under section 263A using the burden rate method provided in §1.263A-1(f)(3)(i). In accordance with paragraph (d)(1) of this section, X Corporation must change the inventory methods of T Corporation's manufacturing business to the principal methods. Under paragraph (a)(3) of this section, X Corporation also must change either its golf equipment manufacturing business or its tennis equipment manufacturing business, depending on which principal method X Corporation selects, to the principal method.

*(d) Procedures for changing a method of accounting—(1) Change made to principal method under paragraph (a)(3) of this section—(i) Section 481(a) adjustment—(A) In general.* An acquiring corporation that changes its method of accounting or the distributor or transferor corporation's method of accounting under paragraph (a)(3) of this section does not need to secure the Commissioner's consent to use a principal method. To the extent the use of a principal method constitutes a change in method of accounting, the change in method is treated as a change initiated by the acquiring corporation for purposes of section 481(a)(2). Any change to a principal method, whether the change relates to a trade or business of the acquiring corporation or a trade or business of the distributor or transferor corporation, must be reflected on the acquiring corporation's federal income tax return for the taxable year that includes the date of distribution or transfer. The amount of the section 481(a) adjustment and the adjustment period, if any, necessary to implement a change to the principal method are determined under §1.446-1(e) and the applicable administrative procedures that govern voluntary changes in methods of accounting under section 446(e). If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require that a method of accounting be implemented on a cut-off basis, the acquiring corporation must implement the change, on a cut-off basis as of the date of distribution or transfer, on its federal income tax return for the taxable year that includes the date of distribution or transfer. If the Internal Revenue Code, the Income Tax Regulations, or administrative procedures require a section 481(a) adjustment, the acquiring corporation must determine the section 481(a) adjustment and include the

appropriate amount of the section 481(a) adjustment on its federal income tax return for the taxable year that includes the date of distribution or transfer and subsequent taxable year(s), as necessary. This adjustment is determined by the acquiring corporation as of the beginning of the day that is immediately after the date of distribution or transfer.

*(B) Example.* The following example illustrates the rules of this paragraph (d)(1)(i):

*Example.* X Corporation uses the FIFO method of inventory identification, and T Corporation uses the LIFO method of inventory identification. X Corporation acquires the inventory of T Corporation in a transaction to which section 381(a) applies. X Corporation determines that under the rules of paragraph (c)(1) of this section, X Corporation must change the inventory method for the business acquired from T Corporation to the FIFO method. X Corporation will determine the section 481(a) adjustment pertaining to the change to the FIFO method (whether the amounts thereof represent increases or decreases in income) as of the beginning of the day that immediately follows the day on which X Corporation acquires the inventory of T Corporation. X Corporation will reflect this adjustment, or an appropriate part thereof, on its federal income tax return for the taxable year that includes the date of distribution or transfer.

*(ii) Audit protection.* Notwithstanding any other provision in any other Income Tax Regulation or administrative procedure, no audit protection is provided for any change in method of accounting under paragraph (d)(1) of this section.

*(iii) Other terms and conditions.* Except as otherwise provided in this section, other terms and conditions provided in §1.446-1(e) and the applicable administrative procedures for voluntary changes in method of accounting under section 446(e) apply to a change in method of accounting under this section. Thus, for example, if the administrative procedures for a particular change in method of accounting have a term and condition that provides for the acceleration of the section 481(a) adjustment period, this term and condition applies to a change made under this paragraph (d)(1). However, any scope limitation in the applicable administrative procedures will not apply for purposes of making a change under this paragraph (d)(1). For example, if the administrative procedures provide as a limitation that an identical change in method of accounting is barred for a period of years, this limitation will not bar a change to the principal method made under this section.

(2) *Change made to a method of accounting under paragraph (a)(4) or (a)(5) of this section*—(i) *In general.* A party to a section 381(a) transaction that changes a method of accounting under either paragraph (a)(4) or paragraph (a)(5) of this section must follow the provisions of §1.446–1(e) and the applicable administrative procedures, including scope limitations, for voluntary changes in method of accounting under section 446(e), except as provided in paragraphs (d)(2)(ii) and (d)(2)(iii) of this section. An application on Form 3115, “*Application for Change in Accounting Method*,” filed with the IRS to change a method of accounting under this paragraph (d)(2) should be labeled “Filed under section 381(c)(5)” at the top.

(ii) *Final year limitation.* Any scope limitation relating to the final year of a trade or business will not apply to a taxpayer that changes its method of accounting in the final year of a trade or business that is terminated as the result of a section 381(a) transaction.

(iii) *Time to file.* Under the authority of §1.446–1(e)(3)(ii), for a change in method of accounting requiring advance consent, the application for a change in method of accounting (for example, Form 3115), must be filed with the IRS on or before the later of—

(A) The due date for filing a Form 3115 as specified in §1.446–1(e), for example, the last day of the taxable year in which the distribution or transfer occurred, or

(B) The earlier of—

(1) The day that is 180 days after the date of distribution or transfer, or

(2) The day on which the acquiring corporation files its federal income tax return for the taxable year in which the distribution or transfer occurred.

(e) *Rules and procedures*—(1) *Inventory method selected for a particular type of goods.* If other sections of the Internal Revenue Code or Income Tax Regulations allow a taxpayer to elect an inventory method for a particular type of goods, the method elected with respect to those goods is the established inventory method only for those goods. For example, an election to use the LIFO inventory method to identify specified goods in inventory, such as certain products in finished goods, is the inventory method only for those products.

(2) *No method of accounting.* If a party to a section 381(a) transaction is not us-

ing an inventory method, does not have an inventory method for a particular type of goods, or came into existence as a result of the transaction, the party will not be treated as having an inventory method different from that used by another party to the section 381(a) transaction.

(3) *Elections and adoptions allowed.* If an election does not require the Commissioner’s consent, an acquiring corporation or a distributor or transferor corporation is not precluded from making any election that is otherwise permissible for the taxable year that includes the date of distribution or transfer. For example, an acquiring corporation may elect to identify its inventory using the LIFO inventory method in the year of the distribution or transfer. For purposes of this section, a corporation shall be deemed as having made any election as of the first day of the taxable year that includes the date of distribution or transfer. Similarly, where adoption is permissible, an acquiring corporation or a distributor or transferor corporation may adopt any permissible method of accounting for the taxable year that includes the date of distribution or transfer.

(4) *Elections continue after section 381(a) transaction*—(i) *General rule.* An acquiring corporation is not required to renew any election not requiring renewal and previously made by it or by a distributor or transferor corporation for a carryover method or a principal method if the acquiring corporation uses the method after the section 381(a) transaction. If the acquiring corporation uses a method after the date of distribution or transfer, an election made by the acquiring corporation or by a distributor or transferor corporation for that method that was in effect on the date of distribution or transfer continues after the section 381(a) transaction as though the distribution or transfer had not occurred.

(ii) *Example.* The following example illustrates the rules of paragraph (e)(4):

*Example.* Since its incorporation in 1982, X Corporation elected to use the LIFO inventory method under section 472 to identify its inventory of tennis balls. Since its incorporation in 2002, T Corporation elected to use the FIFO inventory method to identify its inventory of tennis balls. X Corporation acquires the assets of T Corporation in a transaction to which section 381(a) applies. Immediately prior to the date of distribution or transfer, the fair market value of X Corporation’s inventory in its tennis balls exceeds the fair market value of the tennis balls inventory held by T Corporation. After the date of distribution or trans-

fer, X Corporation will not operate its business as a trade or business that is separate and distinct from T Corporation’s business. Because on the date of distribution or transfer T Corporation does not hold more inventory than X Corporation, the principal method for identifying inventory is the method used by X Corporation on the date of distribution or transfer. After the date of distribution or transfer, X Corporation need not renew its election to identify inventory using the LIFO inventory method, and X Corporation is bound by the election.

(5) *Adopting the LIFO inventory method.* A party to a section 381(a) transaction will be deemed to be using the LIFO inventory method for a particular type of goods on the date of distribution or transfer if that party elects under section 472 to adopt that inventory method with respect to those goods for its taxable year within which the date of distribution or transfer occurs. See section 472 for the requirements to adopt the LIFO inventory method.

(6) *Inventory layers treatment*—(i) *Adjustments required after a section 381(a) transaction.* An acquiring corporation that determines the principal method of taking an inventory after a section 381(a) transaction under paragraphs (a)(3) and (c) of this section after the date of distribution or transfer may need to integrate inventories and make appropriate adjustments as provided in paragraphs (e)(6)(ii) and (e)(6)(iii) of this section.

(ii) *LIFO inventory method used after the section 381(a) transaction*—(A) *LIFO inventory method used by the acquiring corporation and the distributor or transferor corporation*—(1) *Principal method is the dollar-value LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the specific goods LIFO method of pricing inventories to the dollar-value LIFO method of pricing inventories (dollar-value LIFO method) for a particular type of goods, the inventory accounted for under the specific goods method shall be placed on the dollar-value method as provided in §1.472–8(f), and then the inventory shall be integrated with the inventory previously accounted for under the dollar-value LIFO method. If pools of each corporation are permitted or required to be combined, the pools must be combined as provided in §1.472–8(g)(2). For purposes of combining pools, all base year inven-

tories or layers of increment that occur in taxable years including the same December 31 shall be combined. A base year inventory or layer of increment occurring in any short taxable year of a distributor or transferor corporation shall be merged with and considered a layer of increment of its immediately preceding taxable year.

(2) *Principal method is the specific goods LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the dollar-value LIFO method of pricing inventories to the specific goods LIFO method of pricing inventories, the acquiring corporation shall treat the inventory being changed to the specific goods LIFO method as having the same acquisition dates and costs as such inventory had under the dollar-value LIFO method.

(B) *Change from the FIFO inventory method to either the specific goods LIFO method or the dollar-value LIFO method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from the FIFO inventory method to either the specific goods LIFO method or the dollar-value method of pricing LIFO inventories, the inventory accounted for under the FIFO inventory method shall be treated by the acquiring corporation as having been acquired at their average unit cost in a single transaction on the date of the distribution or transfer. Thus, if an inventory of a particular type of goods is combined in an existing dollar-value pool, the goods shall be treated as if they were purchased by the acquiring corporation at the average unit cost on the date of the distribution or transfer with respect to such pool. Alternatively, if the goods are not combined in an existing pool, the goods will be treated as if they were purchased by the acquiring corporation at the average unit cost on the date of the distribution or transfer with respect to a new pool, with the base-year being the year of the section 381(a) transaction. Adjustments resulting from a restoration to cost of any write-down to market value of the inventories shall be taken into account by the acquiring corporation ratably in each of the three taxable years beginning with the taxable year that includes the date of

the distribution or transfer. See section 472(d).

(iii) *FIFO inventory method used after the section 381(a) transaction—(A) FIFO inventory method used by the acquiring corporation and the distributor or transferor corporation.* If, under paragraphs (a)(3) and (c) of this section, the FIFO inventory method is the principal method and the component trades or businesses of both the acquiring corporation and the distributor or transferor corporation use the FIFO method immediately prior to the distribution or transfer, the acquiring corporation must treat the inventory that must change to the principal method as having the same acquisition dates and costs as such inventory had immediately prior to the date of distribution or transfer. However, if the principal method of valuing inventories is the cost or market, whichever is lower, method, the acquiring corporation must treat the inventories that must change to the principal method as having been acquired at cost or market, whichever is lower.

(B) *Change from either the specific goods LIFO method or the dollar-value LIFO method to the FIFO inventory method.* If, under paragraphs (a)(3) and (c) of this section, the acquiring corporation changes its inventory method or the inventory method of the distributor or transferor corporation from either the specific goods LIFO method or the dollar-value LIFO method to the FIFO inventory method, the acquiring corporation must treat the inventory accounted for under the LIFO method as having the same acquisition dates and costs that the inventory would have had if the FIFO inventory method had been used on the date of distribution or transfer. However, if the principal method of valuing inventories is the cost or market, whichever is lower, method, the acquiring corporation must treat the inventories accounted for under the LIFO method as having been acquired at cost or market, whichever is lower.

(7) *Appropriate times for certain determinations—(i) Determining the inventory method.* The inventory method used by a party to a section 381(a) transaction on the date of distribution or transfer is the method used by that party as of the end of the day that is immediately prior to the date of distribution or transfer.

(ii) *Determining whether there are separate and distinct trades or businesses after the date of distribution or transfer.* Whether an acquiring corporation will operate the trades or businesses of the parties to a section 381(a) transaction as separate and distinct trades or businesses after the date of distribution or transfer will be determined as of the date of distribution or transfer based upon the facts and circumstances. Intent to combine books and records of the trades or businesses may be demonstrated by contemporaneous records and documents or by other objective evidence that reflects the acquiring corporation's ultimate plan of operation, even though the actual combination of the books and records may extend beyond the end of the taxable year that includes the date of distribution or transfer.

(8) *Establishing an inventory method.* An inventory method used by the distributor or transferor corporation immediately prior to the date of distribution or transfer that continues to be used by the acquiring corporation after the date of distribution or transfer is an established method of accounting for purposes of section 446(e), whether or not such method is proper or is permitted under the Internal Revenue Code or any applicable Income Tax Regulations.

(9) *Other applicable provisions.* This section does not preempt any other provision of the Internal Revenue Code or the Income Tax Regulations that is applicable to the acquiring corporation's circumstances. Section 381(c)(5) and this §1.381(c)(5)–1 determine only the inventory method to be used after a section 381(a) transaction. If other paragraphs of section 381(c) apply for purposes of determining the methods of accounting to be used following the date of distribution or transfer, section 381(c)(5) and this §1.381(c)(5)–1 will not apply to the tax treatment of the items. Specifically, section 381(c)(5) and this §1.381(c)(5)–1 do not apply to assets other than inventory that an acquiring corporation obtains in a transaction to which section 381(a) applies.

(10) *Use of the cash receipts and disbursements method of accounting.* If immediately prior to the date of distribution or transfer, an acquiring corporation or a distributor or transferor corporation uses the cash receipts and disbursements

method of accounting within the meaning of section 446(c)(1) and §1.446-1(c)(1)(i), or is not required to use an inventory method for its goods, section 381(c)(5) and §1.381(c)(5)-1 do not apply. Instead, section 381(c)(4) and §1.381(c)(4)-1 must be applied to determine the methods of accounting that continue after the transaction.

(11) *Character of items of income and deduction.* After the date of distribution or transfer, items of income and deduction have the same character in the hands of the acquiring corporation as they would have had in the hands of the distributor or transferor corporation if no distribution or transfer had occurred.

(12) *Impermissible inventory method.* This section does not limit the Commissioner's ability under section 446(b) to determine whether a taxpayer's inventory method is an impermissible method or otherwise fails to clearly reflect income. For example, an acquiring corporation may not use the method of accounting determined under paragraph (a)(2) of this section if the method fails to clearly reflect the acquiring corporation's income within the meaning of section 446(b).

(f) *Effective/applicability date.* This section applies to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Par. 5. Section 1.446-1 is amended by:

1. Revising the first sentence and adding a second new sentence in paragraph (e)(3)(i).

2. Revising the first sentence in paragraph (e)(4)(i).

3. Adding paragraph (e)(4)(iii).

The revisions and addition read as follows:

*§1.446-1 General rule for methods of accounting.*

\* \* \* \* \*

(e) \* \* \*

(3)(i) Except as otherwise provided under the authority of paragraph (e)(3)(ii) of this section, to secure the Commissioner's consent to a taxpayer's change in

method of accounting the taxpayer generally must file an application on Form 3115, "Application for Change in Accounting Method," with the Commissioner during the taxable year in which the taxpayer desires to make the change in method of accounting. See §§1.381(c)(4)-1(d)(2) and 1.381(c)(5)-1(d)(2) for rules allowing additional time, in some circumstances, for the filing of an application on Form 3115 with respect to a transaction to which section 381(a) applies. \* \* \*

\* \* \* \* \*

(4) \* \* \*(i) \* \* \* Except as provided in paragraphs (e)(3)(iii), (e)(4)(ii), and (e)(4)(iii) of this section, paragraph (e) of this section applies on or after December 30, 2003. \* \* \*

\* \* \* \* \*

(iii) *Effective/applicability date for paragraph (e)(3)(i).* The rules of paragraph (e)(3)(i) of this section apply to corporate reorganizations and tax-free liquidations described in section 381(a) that occur on or after August 31, 2011.

Steven T. Miller,  
*Deputy Commissioner for  
Services and Enforcement.*

Approved July 20, 2011.

Emily S. McMahon,  
*Acting Assistant Secretary  
for the Treasury (Tax Policy).*

(Filed by the Office of the Federal Register on July 29, 2011, 8:45 a.m., and published in the issue of the Federal Register for August 1, 2011, 76 F.R. 45673)

## Section 2032A.—Valuation of Certain Farm, Etc., Real Property

26 CFR 20.2032A-4: Method of valuing farm real property.

**Special use value; farms; interest rates.** The 2010 and 2011 interest rates to be used in computing the special use value of farm real property for which an election

is made under section 2032A of the Code are listed for estates of decedents.

## Rev. Rul. 2011-17

This revenue ruling contains a list of the average annual effective interest rates on new loans under the Farm Credit System. This revenue ruling also contains a list of the states within each Farm Credit System Bank Chartered Territory.

Under § 2032A(e)(7)(A)(ii) of the Internal Revenue Code, rates on new Farm Credit System Bank loans are used in computing the special use value of real property used as a farm for which an election is made under § 2032A. The rates in Table 1 of this revenue ruling may be used by estates that value farmland under § 2032A as of a date in 2010. The rates in Table 2 of this revenue ruling may be used by estates that value farmland under § 2032A as of a date in 2011.

Average annual effective interest rates, calculated in accordance with § 2032A(e)(7)(A) and § 20.2032A-4(e) of the Estate Tax Regulations, to be used under § 2032A(e)(7)(A)(ii), are set forth in the accompanying Tables of Interest Rates (Table 1 and 2). The states within each Farm Credit System Bank Chartered Territory are set forth in the accompanying Table of Farm Credit System Bank Chartered Territories (Table 3).

Rev. Rul. 81-170, 1981-1 C.B. 454, contains an illustrative computation of an average annual effective interest rate. The rates applicable for valuation in 2009 are in Rev. Rul. 2009-21, 2009-30 I.R.B. 162. For rate information for years prior to 2009, see Rev. Rul. 2008-44, 2008-2 C.B. 292, and other revenue rulings that are referenced therein.

### DRAFTING INFORMATION

The principal author of this revenue ruling is Lane Damazo of the Office of the Associate Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling, contact Lane Damazo at (202) 622-3090 (not a toll-free call).

REV. RUL. 2011-17 TABLE 1

TABLE OF INTEREST RATES  
(Year of Valuation 2010)

Farm Credit System Bank Servicing State in Which Property is Located	Rate
AgFirst, FCB .....	7.48
AgriBank, FCB .....	6.41
CoBank, ACB .....	6.07
Texas, FCB .....	6.45
U.S. AgBank, FCB .....	6.15

REV. RUL. 2011-17 TABLE 2

TABLE OF INTEREST RATES  
(Year of Valuation 2011)

Farm Credit System Bank Servicing State in Which Property is Located	Rate
AgFirst, FCB .....	6.97
AgriBank, FCB .....	6.12
CoBank, ACB .....	5.78
Texas, FCB .....	6.04
U.S. AgBank, FCB .....	5.88

REV. RUL. 2011-17 TABLE 3

TABLE OF FARM CREDIT SYSTEM BANK CHARTERED TERRITORIES

Farm Credit System Bank	Location of Property
AgFirst, FCB .....	Delaware, District of Columbia, Florida, Georgia, Maryland, North Carolina, Pennsylvania, South Carolina, Virginia, West Virginia.
AgriBank, FCB .....	Arkansas, Illinois, Indiana, Iowa, Kentucky, Michigan, Minnesota, Missouri, Nebraska, North Dakota, Ohio, South Dakota, Tennessee, Wisconsin, Wyoming.
CoBank, ACB .....	Alaska, Connecticut, Idaho, Maine, Massachusetts, Montana, New Hampshire, New Jersey, New York, Oregon, Rhode Island, Vermont, Washington.
Texas, FCB .....	Alabama, Louisiana, Mississippi, Texas.
U.S. Agbank, FCB.....	Arizona, California, Colorado, Hawaii, Kansas, New Mexico, Nevada, Oklahoma, Utah.

# Part IV. Items of General Interest

## Notice of Proposed Rulemaking by Cross-Reference to Temporary Regulations

### Modification of Treasury Regulations Pursuant to Section 939A of the Dodd-Frank Wall Street Reform and Consumer Protection Act

#### REG-118809-11

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In this issue of the Bulletin, the IRS is issuing final and temporary regulations that remove any reference to, or requirement of reliance on, credit ratings in regulations under the Internal Revenue Code (Code) and provide substitute standards of credit-worthiness where appropriate. The Dodd-Frank Wall Street Reform and Consumer Protection Act requires each Federal agency to take such actions regarding its regulations. These regulations affect persons subject to various provisions of the Code. The text of the temporary regulations published in this issue of the Bulletin also serves as the text of the proposed regulations.

DATES: Written and electronic comments and requests for a public hearing must be received by September 5, 2011.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-118809-11), Room 5203, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered to: CC:PA:LPD:PR Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-118809-11), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, or sent

electronically via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS REG-118809-11).

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Arturo Estrada, (202) 622-3900; concerning submissions of comments and requests for a public hearing, Oluwafunmilayo Taylor, (202) 622-7180 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Section 939A(a) of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203 (124 Stat. 1376 (2010)), (the "Dodd-Frank Act"), requires each Federal agency to review its regulations that require the use of an assessment of credit-worthiness of a security or money market instrument, and to review any references or requirements in those regulations regarding credit ratings. Section 939A(b) directs each agency to modify any regulation identified in the review required under section 939A(a) by removing any reference to, or requirement of reliance on, credit ratings and substituting a standard of credit-worthiness that the agency deems appropriate. Numerous provisions under the Code are affected.

Temporary regulations in this issue of the Bulletin amend the Income Tax Regulations (26 CFR part 1) under sections 150, 171, 197, 249, 475, 860G, and 1001 of the Code. The temporary regulations also amend the Manufacturers and Retailers Excise Tax Regulations (26 CFR part 48) under section 4101 of the Code. The text of the temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations and the 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, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It

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 on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking 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 electronic comments that are submitted timely to the IRS. The IRS and the Treasury Department specifically request comments on the clarity of the proposed regulations and how they 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 any person that timely submits written 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

These regulations were drafted by personnel in the Office of Associate Chief Counsel (Financial Institutions and Products), the Office of Associate Chief Counsel (Income Tax and Accounting), the Office of Associate Chief Counsel (International) and the Office of the Associate Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and the Treasury Department participated in their development.

\* \* \* \* \*

##### Proposed Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 48 are proposed to be amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.150-1 is amended as follows:

1. Paragraph (a)(4) is added.

2. In paragraph (b), the definition of *Issuance costs*, is revised.

The addition and revision read as follows:

§1.150-1 Definitions.

\* \* \* \* \*

(4) [The text of the proposed amendments to §1.150-1(a)(4) is the same as the text of §1.150-1T(a)(4) published elsewhere in this issue of the Bulletin].

(b) \* \* \*

*Issuance costs.* [The text of the proposed amendments to §1.150-1(b), *Issuance costs*, is the same as the text of §1.150-1T(b), *Issuance costs*, published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

Par. 3. Section 1.171-1 is amended by revising paragraph (f) *Example 2* to read as follows:

§1.171-1 Bond premium.

\* \* \* \* \*

(f) \* \* \*

*Example 2.* [The text of the proposed amendments to §1.171-1(f) *Example 2* is the same as the text of §1.171-1T(f) *Example 2* published elsewhere in this issue of the Bulletin].

Par. 4. Section 1.197-2 is amended by revising paragraph (b)(7) to read as follows:

§1.197-2 Amortization of goodwill and certain other intangibles.

\* \* \* \* \*

(b) \* \* \*

(7) [The text of the proposed amendments to §1.197-2(b)(7) is the same as the text of §1.197-2T(b)(7) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

Par. 5. Section 1.249-1 is amended by revising paragraphs (e)(2)(ii) and adding paragraph (f)(3) to read as follows:

§1.249-1 Limitation on deduction of bond premium on repurchase.

\* \* \* \* \*

(e) \* \* \*

(2) \* \* \*

(ii) [The text of the proposed amendments to §1.249-1(e)(2)(ii) is the same as the text of §1.249-1T(e)(2)(ii) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

(f) *Effective/applicability dates.* \* \* \*

(3) [The text of the proposed amendments to §1.249-1(f)(3) is the same as the text of §1.249-1T(f)(3) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

Par. 6. Section 1.475(a)-4 is amended by revising paragraph (d)(4) *Examples 1, 2, and 3* and paragraph (n) to read as follows:

§1.475(a)-4 Valuation safe harbor.

\* \* \* \* \*

(d) \* \* \*

(4) \* \* \*

*Example 1.* [The text of the proposed amendments to §1.475(a)-(4)(d)(4) *Example 1* is the same as the text of §1.475(a)-4T(d)(4) *Example 1* published elsewhere in this issue of the Bulletin].

*Example 2.* [The text of the proposed amendments to §1.475(a)-4(d)(4) *Example 2* is the same as the text of §1.475(a)-4T(d)(4) *Example 2* published elsewhere in this issue of the Bulletin].

*Example 3.* [The text of the proposed amendments to §1.475(a)-4(d)(4) *Example 3* is the same as the text of §1.475(a)-4T(d)(4) *Example 3* published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

Par. 7. Section 1.860G-2 is amended by revising paragraphs (g)(3)(ii)(B), (C), and (D) to read as follows:

§1.860G-2 Other rules.

\* \* \* \* \*

(g) \* \* \*

(3) \* \* \*

(ii) \* \* \*

(B) [The text of the proposed amendments to §1.860G-2(g)(3)(ii)(B) is the same as the text of §1.860G-2T(g)(3)(ii)(B) published elsewhere in this issue of the Bulletin].

(C) [The text of the proposed amendments to §1.860G-2(g)(3)(ii)(C) is the same as the text of

§1.860G-2T(g)(3)(ii)(C) published elsewhere in this issue of the Bulletin].

(D) [The text of the proposed amendments to §1.860G-2(g)(3)(ii)(D) is the same as the text of §1.860G-2T(g)(3)(ii)(D) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

Par. 8. Section 1.1001-3 is amended as follows:

- 1. Paragraph (d) *Example 9* is revised.
- 2. Paragraph (e)(4)(iv)(B) is revised.
- 3. Paragraph (e)(5)(ii)(B)(2) is revised.
- 4. Paragraph (g) *Examples 1, 5, and 8* are revised.

The revisions read as follows:

§1.1001-3 Modifications of debt instruments.

\* \* \* \* \*

(d) \* \* \*

*Example 9.* [The text of the proposed amendments to §1.1001-3(d) *Example 9* is the same as the text of §1.1001-3T(d) *Example 9* published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

(e) \* \* \*

(4) \* \* \*

(iv) \* \* \*

(B) [The text of the proposed amendments to §1.1001-3(e)(4)(iv)(B) is the same as the text of §1.1001-3T(e)(4)(iv)(B) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

(5) \* \* \*

(ii) \* \* \*

(B) \* \* \*

(2) [The text of the proposed amendments to §1.1001-3(e)(5)(ii)(B)(2) is the same as the text of §1.1001-3T(e)(5)(ii)(B)(2) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

(g) \* \* \*

*Example 1.* [The text of the proposed amendments to §1.1001-3(g) *Example 1* is the same as the text of §1.1001-3T(g) *Example 1* published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

*Example 5.* [The text of the proposed amendments to §1.1001-3(g) *Example 5* is the same as the text of §1.1001-3T(g) *Example 5* published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

*Example 8.* [The text of the proposed amendments to §1.1001-3(g) *Example 8* is the same as the text of §1.1001-3T(g) *Example 8* published elsewhere in this issue of the Bulletin].

## PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 9. The authority citation for part 48 continues to read in part as follows:

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

Par. 10. Section 48.4101-1 paragraphs (f)(4)(ii)(B) and (l)(5) are revised to read as follows:

§48.4101-1 *Taxable fuel; registration.*

\* \* \* \* \*

(f) \* \* \*

(4) \* \* \*

(ii) \* \* \*

(B) [The text of the proposed amendments to §48.4101-1(f)(4)(ii)(B) is the same as the text of §48.4101-1T(f)(4)(ii)(B) published elsewhere in this issue of the Bulletin].

\* \* \* \* \*

(l) \* \* \*

(5) [The text of the proposed amendments to §48.4101-1(l)(5) is the same as the text of §48.4101-1T(l)(5) published elsewhere in this issue of the Bulletin].

Steven T. Miller,  
*Deputy Commissioner for  
Services and Enforcement.*

(Filed by the Office of the Federal Register on July 1, 2011, 11:15 a.m., and published in the issue of the Federal Register for July 6, 2011, 76 F.R. 39341)

# Announcement of Disciplinary Sanctions From the Office of Professional Responsibility

## Announcement 2011-44

The Office of Professional Responsibility (OPR) announces recent disciplinary sanctions involving attorneys, certified public accountants, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and appraisers. These individuals are subject to the regulations governing practice before the Internal Revenue Service (IRS), which are set out in Title 31, Code of Federal Regulations, Part 10, and which are published in pamphlet form as Treasury Department Circular No. 230. The regulations prescribe the duties and restrictions relating to such practice and prescribe the disciplinary sanctions for violating the regulations.

The disciplinary sanctions to be imposed for violation of the regulations are:

**Disbarred from practice before the IRS**—An individual who is disbarred is not eligible to represent taxpayers before the IRS.

**Suspended from practice before the IRS**—An individual who is suspended is not eligible to represent taxpayers before the IRS during the term of the suspension.

**Censured in practice before the IRS**—Censure is a public reprimand. Unlike disbarment or suspension, censure does not affect an individual's eligibility to represent taxpayers before the IRS, but OPR may subject the individual's future representations to conditions designed to promote high standards of conduct.

**Monetary penalty**—A monetary penalty may be imposed on an individual who engages in conduct subject to sanc-

tion or on an employer, firm, or entity if the individual was acting on its behalf and if it knew, or reasonably should have known, of the individual's conduct.

**Disqualification of appraiser**—An appraiser who is disqualified is barred from presenting evidence or testimony in any administrative proceeding before the Department of the Treasury or the IRS.

Under the regulations, attorneys, certified public accountants, enrolled agents, enrolled actuaries, and enrolled retirement plan agents may not assist, or accept assistance from, individuals who are suspended or disbarred with respect to matters constituting practice (*i.e.*, representation) before the IRS, and they may not aid or abet suspended or disbarred individuals to practice before the IRS.

Disciplinary sanctions are described in these terms:

**Disbarred by decision after hearing, Suspended by decision after hearing, Censured by decision after hearing, Monetary penalty imposed after hearing, and Disqualified after hearing**—An administrative law judge (ALJ) conducted an evidentiary hearing upon OPR's complaint alleging violation of the regulations and issued a decision imposing one of these sanctions. After 30 days from the issuance of the decision, in the absence of an appeal, the ALJ's decision became the final agency decision.

**Disbarred by default decision, Suspended by default decision, Censured by default decision, Monetary penalty im-**

**posed by default decision, and Disqualified by default decision**—An ALJ, after finding that no answer to OPR's complaint had been filed, granted OPR's motion for a default judgment and issued a decision imposing one of these sanctions.

**Disbarment by decision on appeal, Suspended by decision on appeal, Censured by decision on appeal, Monetary penalty imposed by decision on appeal, and Disqualified by decision on appeal**—The decision of the ALJ was appealed to the agency appeal authority, acting as the delegate of the Secretary of the Treasury, and the appeal authority issued a decision imposing one of these sanctions.

**Disbarred by consent, Suspended by consent, Censured by consent, Monetary penalty imposed by consent, and Disqualified by consent**—In lieu of a disciplinary proceeding being instituted or continued, an individual offered a consent to one of these sanctions and OPR accepted the offer. Typically, an offer of consent will provide for: suspension for an indefinite term; conditions that the individual must observe during the suspension; and the individual's opportunity, after a stated number of months, to file with OPR a petition for reinstatement affirming compliance with the terms of the consent and affirming current eligibility to practice (*i.e.*, an active professional license or active enrollment status). An enrolled agent or an enrolled retirement

plan agent may also offer to resign in order to avoid a disciplinary proceeding.

**Suspended by decision in expedited proceeding, Suspended by default decision in expedited proceeding, Suspended by consent in expedited proceeding**—OPR instituted an expedited proceeding for suspension (based on certain limited grounds, including loss of a professional license and criminal convictions).

OPR has authority to disclose the grounds for disciplinary sanctions in these

situations: (1) an ALJ or the Secretary’s delegate on appeal has issued a decision on or after September 26, 2007, which was the effective date of amendments to the regulations that permit making such decisions publicly available; (2) the individual has settled a disciplinary case by signing OPR’s “consent to sanction” form, which requires consenting individuals to admit to one or more violations of the regulations and to consent to the disclosure of the individual’s own return information related to the admitted violations (for example,

failure to file Federal income tax returns); or (3) OPR has issued a decision in an expedited proceeding for suspension.

Announcements of disciplinary sanctions appear in the Internal Revenue Bulletin at the earliest practicable date. The sanctions announced below are alphabetized first by the names of states and second by the last names of individuals. Unless otherwise indicated, section numbers (e.g., §10.51) refer to the regulations.

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
<b>Alabama</b>				
Springville	Bowers, David A.	CPA	Suspended by decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from April 26, 2011
<b>Arizona</b>				
Phoenix	Curtis Jr., David W.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from May 27, 2011
Phoenix	Platt, Donna J.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from May 11, 2011
<b>California</b>				
San Diego	Bujkovsky, Gustav G.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (conviction under 18 U.S.C. §1505, obstruction of justice and 26 U.S.C. §7201, income tax evasion )	Indefinite from June 21, 2011
Irvine	Cassidy, Carl R.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from May 4, 2011

City & State	Name	Professional Designation	Disciplinary Sanction	Effective Date(s)
<b>California (Continued)</b>				
Santa Barbara	Frausto, Marco	Enrolled Agent	Censured by consent for admitted violation of §10.22 (failure to exercise due diligence in the preparation of client tax returns)	April 8, 2011
Los Angeles	Henschel, Bradford E.	Attorney	Suspended by decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from May 4, 2011
Los Angeles	Johnson, Eric D.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (attorney disbarment)	Indefinite from April 26, 2011
Clovis	Lima, Richard A.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (suspension of attorney license)	Indefinite from April 22, 2011
Nipomo	Pena Jr., Hilario	CPA	Suspended by decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from June 7, 2011
Rocklin	Shattuck, Alan D.	CPA	Suspended by default decision in expedited proceeding under §10.82 (revocation of CPA license)	Indefinite from May 27, 2011
Escondido	Smith, Todd C.	Attorney	Suspended by default decision in expedited proceeding under §10.82 (conviction under 26 U.S.C. §7201, tax evasion)	Indefinite from June 17, 2011
Atwater	Tomsha-Miguel, Susan R.	Enrolled Agent	Disbarred by ALJ in default decision for violations of §10.51 (failure to file timely Federal income tax returns for tax years 2002–2009, and failure to timely pay Federal tax liability for the years 2002–2004)	Indefinite from March 10, 2011, but at least 5 years

<b>City &amp; State</b>	<b>Name</b>	<b>Professional Designation</b>	<b>Disciplinary Sanction</b>	<b>Effective Date(s)</b>
<b>Colorado</b>				
Colorado Springs	Anderson, Edwin G.	Enrolled Agent	Suspended by consent for admitted violation of §10.22 (failure to exercise due diligence in the determination of the validity of credits and deductions under §44 of the Internal Revenue Code)	Indefinite from May 10, 2011, but at least 6 months
<b>District of Columbia</b>				
	Sangarie, Mohamed B.	Enrolled Agent	Suspended by decision in expedited proceeding under §10.82 (conviction under 26 U.S.C. §7206, aiding and abetting false income tax returns)	Indefinite from May 23, 2011
<b>Florida</b>				
Tallahassee	Davis, James E.	CPA	Suspended by consent for admitted violation of §10.22 (failure to exercise due diligence in preparing his Federal individual income tax returns for tax years 2005–2007) and violation of § 10.51 (failure to timely file Federal individual income tax returns for tax years 2003–2008)	Indefinite from June 1, 2011, but not less than 12 months
<b>Georgia</b>				
Augusta	Cruse, Samuel W.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from April 26, 2011
Conyers	Roberts, Vernon A.	Enrolled Agent	Suspended by default decision in expedited proceeding under § 10.82 (conviction under 18 U.S.C. § 371, conspiracy to commit tax fraud and 26 U.S.C. § 7206 and 18 U.S.C § 2, false claims to the IRS)	Indefinite from April 26, 2011

<b>City &amp; State</b>	<b>Name</b>	<b>Professional Designation</b>	<b>Disciplinary Sanction</b>	<b>Effective Date(s)</b>
<b>Georgia (Continued)</b>				
Jonesboro	Swank, Lynn M.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from April 26, 2011
<b>Indiana</b>				
Greenfield	Wilson, Curtis D.	CPA	Suspended by consent for admitted violation of § 10.51 (failure to timely file Federal individual income tax returns for tax years 1996–2002, 2005, 2006, 2009 and failed to honor the terms of the agreement he had with OPR dated May 12, 2004)	Indefinite from May 13, 2011, but at least 12 months
<b>Kentucky</b>				
Louisville	Reskin, James A.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 17, 2011
<b>Maryland</b>				
Silver Spring	Boykins, James R.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from April 22, 2011
Bethesda	Fox, David E.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 7, 2011
<b>Massachusetts</b>				
Andover	McLaughlin, Peter C.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from June 7, 2011
Florence	Zadworny, Kim E.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from June 17, 2011

<b>City &amp; State</b>	<b>Name</b>	<b>Professional Designation</b>	<b>Disciplinary Sanction</b>	<b>Effective Date(s)</b>
<b>Minnesota</b>				
St. Louis Park	Letourneau, Dennis R.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (suspension of attorney license)	Indefinite from April 22, 2011
Minneapolis	Rooney, Edward F.	Attorney		Reinstated to practice before the IRS, June 17, 2011
<b>Missouri</b>				
Lebanon	Baldwin, James E.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 23, 2011
Ferguson	Grecco, Frances E.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 17, 2011
<b>Nebraska</b>				
Bellevue	Erwin-Loncke, Kim D.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 7, 2011
<b>New Jersey</b>				
	Hauke, Thomas P., See Pennsylvania			
Freehold	Przygoda, Deirdre A.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from April 22, 2011
<b>New York</b>				
Levittown	Barsch, Robert J.	Attorney	Suspended by decision in expedited proceeding under § 10.82 (attorney disbarment)	Indefinite from June 7, 2011
Pleasantville	Bell, Rosanna	CPA		Reinstated to practice before the IRS, June 14, 2011
	Hauke, Thomas P., See Pennsylvania			
Scarsdale	Pirro, Anthony G.	CPA		Reinstated to practice before the IRS, May 4, 2011

<b>City &amp; State</b>	<b>Name</b>	<b>Professional Designation</b>	<b>Disciplinary Sanction</b>	<b>Effective Date(s)</b>
<b>North Carolina</b>				
Asheville	Bullock, Lester E.	CPA	Suspended by decision in expedited proceeding under § 10.82 (revocation of CPA license)	Indefinite from May 27, 2011
Raleigh	Fowler, Roy D.	CPA	Suspended by decision in expedited proceeding under § 10.82 (revocation of CPA license)	Indefinite from June 27, 2011
<b>Oregon</b>				
Prinewille	Holland, Michael W.	CPA	Suspended by decision in expedited proceeding under § 10.82 (conviction under 26 U.S.C. § 7206, assisting in the filing of a false tax return and revocation of CPA license)	Indefinite from May 4, 2011
<b>Pennsylvania</b>				
Wexford	Graham, William J.	CPA	Suspended by decision in expedited proceeding under § 10.82 (suspension of CPA license)	Indefinite from April 15, 2011
Plumsteadville	Hauke, Thomas P.	CPA		Reinstated to practice before the IRS, May 23, 2011
<b>South Carolina</b>				
Edgefield	Monahan, Daniel T.	CPA	Suspended by decision in expedited proceeding under § 10.82 (conviction under 18 U.S.C. § 1341, mail fraud)	Indefinite from June 15, 2011
<b>Texas</b>				
Brownsville	Hernandez, Luis R.	Attorney	Suspended by decision on appeal for violations of § 10.51 (willful failure to timely file Federal income tax returns for 2004 and 2005, and failure to file Federal income tax returns for 2006 and 2007)	Indefinite from May 26, 2011, but at least 40 months

<b>City &amp; State</b>	<b>Name</b>	<b>Professional Designation</b>	<b>Disciplinary Sanction</b>	<b>Effective Date(s)</b>
<b>Texas (Continued)</b>				
La Feria	Labunski, Gail S.	CPA	Suspended by decision in expedited proceeding under § 10.82 (revocation of CPA license)	Indefinite from April 26, 2011
<b>Virginia</b>				
Grundy	Cecil, David E.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (conviction under 18 U.S.C. § 1341, mail fraud, conviction under 18 U.S.C. § 1956(a)(1), money laundering, and under 26 U.S.C. § 7201, tax evasion)	Indefinite from June 14, 2011
<b>Washington</b>				
Gig Harbor	Floyd, Steven W.	CPA	Suspended by default decision in expedited proceeding under § 10.82 (revocation of CPA license)	Indefinite from April 26, 2011
<b>Wisconsin</b>				
Milwaukee	Baldwin, Timothy L.	Attorney	Suspended by decision on appeal for violations of § 10.51 (willful failure to timely file Federal income tax returns for 2002–2006, and failure to file a Federal income tax return for 2007)	Indefinite from June 2, 2011, but at least 24 months
Brookfield	Brady, Leonard V.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (revocation of attorney license)	Indefinite from April 26, 2011
Greenville	Fisher, Scott H.	Attorney	Suspended by default decision in expedited proceeding under § 10.82 (revocation of attorney license)	Indefinite from April 26, 2011

# Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

# Abbreviations

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

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

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

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

## Numerical Finding List<sup>1</sup>

Bulletins 2011–27 through 2011–33

### Announcements:

2011-37, 2011-27 I.R.B. 37  
2011-38, 2011-28 I.R.B. 45  
2011-39, 2011-28 I.R.B. 46  
2011-40, 2011-29 I.R.B. 56  
2011-41, 2011-28 I.R.B. 47  
2011-42, 2011-32 I.R.B. 138  
2011-44, 2011-33 I.R.B. 164

### Notices:

2011-47, 2011-27 I.R.B. 34  
2011-50, 2011-27 I.R.B. 35  
2011-51, 2011-27 I.R.B. 36  
2011-52, 2011-30 I.R.B. 60  
2011-53, 2011-32 I.R.B. 124  
2011-54, 2011-29 I.R.B. 53  
2011-55, 2011-29 I.R.B. 53  
2011-56, 2011-29 I.R.B. 54  
2011-57, 2011-31 I.R.B. 84  
2011-58, 2011-31 I.R.B. 85  
2011-59, 2011-31 I.R.B. 86  
2011-60, 2011-31 I.R.B. 90  
2011-61, 2011-31 I.R.B. 91  
2011-62, 2011-32 I.R.B. 126  
2011-70, 2011-32 I.R.B. 135

### Proposed Regulations:

REG-137128-08, 2011-28 I.R.B. 43  
REG-125592-10, 2011-32 I.R.B. 137  
REG-101352-11, 2011-30 I.R.B. 75  
REG-118809-11, 2011-33 I.R.B. 162

### Revenue Procedures:

2011-38, 2011-30 I.R.B. 66  
2011-39, 2011-30 I.R.B. 68

### Revenue Rulings:

2011-14, 2011-27 I.R.B. 31  
2011-15, 2011-30 I.R.B. 57  
2011-16, 2011-32 I.R.B. 93  
2011-17, 2011-33 I.R.B. 160

### Treasury Decisions:

9527, 2011-27 I.R.B. 1  
9528, 2011-28 I.R.B. 38  
9529, 2011-30 I.R.B. 57  
9530, 2011-31 I.R.B. 77  
9531, 2011-31 I.R.B. 79  
9532, 2011-32 I.R.B. 95  
9533, 2011-33 I.R.B. 139  
9534, 2011-33 I.R.B. 144

<sup>1</sup> A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2011–1 through 2011–26 is in Internal Revenue Bulletin 2011–26, dated June 27, 2011.

## **Finding List of Current Actions on Previously Published Items<sup>1</sup>**

Bulletins 2011–27 through 2011–33

### **Notices:**

#### **2010-23**

Modified and supplemented by  
Notice 2011-54, 2011-29 I.R.B. 53

#### **2010-88**

Modified by  
Ann. 2011-40, 2011-29 I.R.B. 56

### **Proposed Regulations:**

#### **REG-118761-09**

Hearing scheduled by  
Ann. 2011-38, 2011-28 I.R.B. 45

### **Revenue Procedures:**

#### **2008-24**

Modified and superseded by  
Rev. Proc. 2011-38, 2011-30 I.R.B. 66

#### **2008-32**

Superseded by  
Rev. Proc. 2011-39, 2011-30 I.R.B. 68

### **Revenue Rulings:**

#### **58-225**

Obsoleted by  
Rev. Rul. 2011-15, 2011-30 I.R.B. 57

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<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2011–1 through 2011–26 is in Internal Revenue Bulletin 2011–26, dated June 27, 2011.



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