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

Clarification and Modification of Notice 2013–29 and Notice 2013–60. This notice clarifies and modifies Notice 2013–29 and Notice 2013–60 regarding the application of the Physical Work Test, the ability to transfer a facility after construction has begun, and modifies the application of the Safe Harbor for certain facilities with respect to which a taxpayer paid or incurred less than five percent, but at least three percent, of the total cost of the facility before January 1, 2014.

This revenue procedure provides the exclusive procedures for taxpayers to obtain the automatic consent of the Commissioner to change a method of accounting under the retail inventory method to comply with final regulations under § 471 of the Code. The final regulations (TD 9688) were published in the Federal Register on August 15, 2014.

T.D. 9687, page 486.
This document contains final regulations that provide comprehensive guidance for the award program authorized under Internal Revenue Code section 7623. These regulations are effective on August 12, 2014.

T.D. 9688, page 482.
Final regulations provide rules under section 471 of the Code relating to the retail inventory method of accounting. The final regulations clarify the computation of ending inventory values under the retail inventory method and provide special rules for vendor allowances required to reduce only cost of goods sold and for margin protection payments. These regulations are effective on August 15, 2014.

Final regulations regarding dispositions of property subject to depreciation under section 168 of the Internal Revenue Code (Modified Accelerated Cost Recovery System (MACRS) property). The final regulations also amend the general asset account regulations under § 1.168(i)–1 and the accounting for MACRS property regulations under § 1.168(i)–7. The final regulations provide rules for determining gain or loss upon the disposition of MACRS property, determining the asset disposed of, and accounting for partial dispositions of MACRS property. The final regulations also remove temporary regulations under section 168 regarding general asset accounts and disposition of MACRS property. These regulations are effective on August 18, 2014.

EMPLOYEE PLANS

This notice sets forth updates on the corporate bond monthly yield curve, the corresponding spot segment rates for July 2014 used under § 417(e)(3)(D), the 24-month average segment rates applicable for August 2014, and the 30-year Treasury rates. These rates reflect the application of § 430(h)(2)(C)(iv), which was added by the Moving Ahead for Progress in the 21st Century Act, Public Law 112–141 (MAP-21) and amended by section 2003 of the Highway and Transportation Funding Act of 2014 (HATFA).

(Continued on the next page)
Section 9010 of the Patient Protection and Affordable Care Act (PPACA), Public Law 111–148 (124 Stat. 119 (2010)), as amended by § 10905 of PPACA, and as further amended by § 1406 of the Health Care and Education Reconciliation Act of 2010, Public Law 111–152 (124 Stat. 1029 (2010)) imposes an annual fee on certain health insurance providers. Notice 2014–47 clarifies how the Internal Revenue Service and the Department of Treasury will administer the definition of a “covered entity” for the 2014 fee year. Entities that meet the requirements of an exclusion under § 9010(c)(2) to the definition of a covered entity for the entire 2013 data year or for the entire 2014 fee year, will not be treated as covered entities for purposes of the 2014 fee year. Additionally, a controlled group should not report in 2014 the net premiums written in 2013 of a controlled group member who would not qualify as a covered entity in the 2014 fee year if it were a stand-alone entity. The notice applies only to the 2014 fee year.
The IRS Mission

Provide America’s taxpayers top-quality service by helping them understand and meet their tax responsibilities and enforce 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.

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

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

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

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

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

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

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

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

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

Section 168.— Accelerated cost recovery system

T.D. 9689

26 CFR 1.168(i)–8T—Dispositions of MACRS Property (Temporary).

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Guidance Regarding Dispositions of Tangible Depreciable Property

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations and removal of temporary regulations.

SUMMARY: This document contains final regulations regarding dispositions of property subject to depreciation under section 168 of the Internal Revenue Code (Code) (Modified Accelerated Cost Recovery System (MACRS) property). The final regulations also amend the general asset account regulations and the accounting for MACRS property regulations. The final regulations provide rules for determining gain or loss upon the disposition of MACRS property, determining the asset disposed of, and accounting for partial dispositions of MACRS property. The final regulations affect taxpayers that dispose of MACRS property. The final regulations also remove temporary regulations under section 168 regarding general asset accounts and disposition of MACRS property.

DATES: Effective Date: These regulations are effective on August 18, 2014.

Applicability Dates: These regulations apply to taxable years beginning on or after January 1, 2014. For dates of applicability of the final regulations, see 1.168(i)–1(m), 1.168(i)–7(e), and 1.168(i)–8(j).

FOR FURTHER INFORMATION CONTACT: Kathleen Reed or Patrick Clinton, Office of Associate Chief Counsel (Income Tax and Accounting), (202) 317-7005 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 27, 2011, the IRS and the Treasury Department published in the Federal Register (76 FR 81060) temporary regulations (TD 9564) regarding the accounting for, and dispositions of, property subject to depreciation under section 168 (MACRS property). The temporary regulations also amended the general asset account regulations under § 1.168(i)–1. On the same date, the IRS published in the Federal Register (76 FR 81128) a notice of proposed rulemaking (REG–168745–03) cross-referencing the temporary regulations (2011 proposed regulations). The IRS and the Treasury Department received numerous written comments responding to the 2011 proposed regulations and held a public hearing on May 9, 2012.

The temporary regulations initially applied to taxable years beginning on or after January 1, 2012. In response to the comments received and the statements made at the public hearing, the IRS and the Treasury Department released Notice 2012–73, 2012–51 IRB 713, on November 20, 2012, announcing that, to help taxpayers transition to the final regulations, the IRS and the Treasury Department would change the applicability date of the temporary regulations to taxable years beginning on or after January 1, 2014, while permitting taxpayers to choose to apply the temporary regulations to taxable years beginning on or after January 1, 2014, and before the applicability date of the final regulations. Notice 2012–73 also alerted taxpayers that the IRS and the Treasury Department intended to revise the disposition rules in the temporary regulations. After considering the comment letters and the statements made at the public hearing, the IRS and the Treasury Department removed the temporary regulations under section 167 and § 1.168(i)–7 and issued final regulations in the Federal Register on September 19, 2013 (78 FR 57686). The final regulations under section 167 provide rules for depreciation of leasehold improvements and amend existing regulations under section 167 regarding accounting for and retirement of depreciable property. Section 1.168(i)–7 provides rules for how to account for MACRS property. On the same date, the IRS also withdrew the 2011 proposed regulations under §§ 1.168(i)–1 and 1.168(i)–8 and published a notice of proposed rulemaking (REG–110732–13) under §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 (2013 proposed regulations) in the Federal Register (78 FR 57547). The 2011 proposed regulations under § 1.168(i)–1 amended the existing regulations on general asset accounts, and the 2011 proposed regulations under § 1.168(i)–8 provided rules for dispositions of MACRS property. The IRS and the Treasury Department did not withdraw or remove the temporary regulations under §§ 1.168(i)–1T and 1.168(i)–8T and taxpayers continued to have the option of applying those temporary regulations to taxable years beginning on or after January 1, 2012, and before the applicability date of the final regulations.

September 2, 2014
No comments were received from the public in response to the 2013 proposed regulations. No public hearing was requested or held. However, the IRS and the Treasury Department are making clarifying changes to the 2013 proposed regulations regarding the determination of the unadjusted depreciable basis of a disposed asset in a general or multiple asset account or a disposed portion of an asset, and the manner of making certain disposition elections for assets included in a general asset account when section 280B applies.

These revisions are discussed in this preamble. The IRS and the Treasury Department are removing the temporary regulations under §§ 1.168(i)–1T and 1.168(i)–8T and are issuing final regulations under §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8. The 2013 proposed regulations are adopted as amended by this Treasury decision.

**Explanation of Provisions and Revisions**

I. Overview

The final regulations under §§ 1.168(i)–1, 1.168(i)–7, and 1.168(i)–8 generally retain all of the provisions of the 2013 proposed regulations. Section 1.168(i)–1 amends the existing general asset account regulations regarding establishment of general asset accounts, depreciation of a general asset account, and dispositions of assets in a general asset account. Section 1.168(i)–7 amends the existing regulations on accounting for MACRS property to address partial dispositions of MACRS property. Section 1.168(i)–8 provides rules for dispositions of MACRS property. These final regulations generally apply to taxable years beginning on or after January 1, 2014.

II. Disposition Rules for MACRS Property Under § 1.168(i)–8

Section 1.168(i)–8 provides the basic rules applicable to dispositions of MACRS property, and § 1.168(i)–1 provides special rules applicable to MACRS property included in a general asset account.

A. Definition of disposition

The final regulations retain the definition of “disposition” for MACRS property that is set forth in the 2013 proposed regulations. A disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also includes the retirement of a structural component (or a portion thereof) of a building only if the partial disposition rule (discussed in II.C) applies to such structural component (or a portion thereof). Finally, the manner of disposition (for example, abnormal retirement or normal retirement) is not taken into consideration in determining whether a disposition occurs or gain or loss is recognized.

B. Determining appropriate disposed asset

The final regulations also retain the rules in the 2013 proposed regulations for determining the disposed asset for tax disposition purposes. In general, the facts and circumstances of each disposition are considered in determining the appropriate disposed asset. However and as provided in the 2013 proposed regulations, the asset for tax disposition purposes may not consist of items placed in service by the taxpayer on different dates (without taking into account the applicable convention).

Further, the unit of property as determined under § 1.263(a)–3(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) does not apply for purposes of determining what is the appropriate disposed asset.

In addition to these general rules, the final regulations provide special rules for certain types of properties. The final regulations retain the rule in the 2013 proposed regulations that each building (including its structural components) is the asset for tax disposition purposes, unless more than one building (including its structural components) is treated as the asset under § 1.1250–1(a)(2)(ii), there is an improvement or addition to an existing building (including its structural components), or the building includes two or more condominium or cooperative units.

If there is an improvement or addition to an existing building (including its structural components), the improvement or addition is the asset. If a building includes two or more condominium or cooperative units, each condominium or cooperative unit (including its structural components) is the asset.

The final regulations also provide that if a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56 (1987–2 CB 674) or classifies an item in one of the categories under section 168(e)(3) (other than a category that includes buildings or structural components; for example, retail motor fuel outlet and qualified leasehold improvement property), each item is the asset provided it is not an improvement or addition to an existing asset.

Finally, and consistent with section 168(i)(6), the final regulations provide that if the taxpayer places in service an improvement or addition to an asset after the taxpayer placed the asset in service, the improvement or addition is a separate asset.

C. Partial dispositions

The final regulations also retain the partial disposition rule in the 2013 proposed regulations. Consequently, the disposition rules in the final regulations apply to a partial disposition of an asset (for example, the disposition of a roof (or a portion of a roof)). The partial disposition rule allows taxpayers to claim a loss upon the disposition of a structural component (or a portion thereof) of a building or upon the disposition of a component (or a portion thereof) of any other asset without identifying the component as an asset before the disposition event. The partial disposition rule also minimizes circumstances in which an original part and any subsequent replacements of the same part are required to be capitalized and depreciated simultaneously. These final regulations provide examples demonstrating the application of the partial disposition rule.

In many cases, the partial disposition rule is elective (“partial disposition election”). However, consistent with the 2013 proposed regulations and the operation of sections 165, 168(i)(7), 1031, and 1033, and because sales of a portion of an asset are common, the partial disposition rule is required to be applied to a disposition of a portion of an asset as a result of a casualty event described in section 165, to a disposition of a portion of an asset for which gain (determined without regard to section 1245 or 1250) is not recognized in whole or in part under section 1031 or 1033, to a
transfer of a portion of an asset in a step-in-the-shoes transaction described in section 168(i)(7)(B), or to a sale of a portion of an asset. Consequently, a disposition includes a disposition of a portion of an asset under these circumstances, even if the taxpayer does not make the partial disposition election for that disposed portion. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the partial disposition election for that disposed portion.

A taxpayer may make the partial disposition election for the disposition of a portion of any type of MACRS property, including an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56. However, consistent with section 168(i)(6) and the 2013 proposed regulations, a taxpayer making the partial disposition election for the disposition of a portion of an asset that is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56 must classify the replacement portion of the asset under the same asset class as the disposed portion of the asset.

The partial disposition election is made on the taxpayer’s timely filed original Federal tax return, including extensions, for the taxable year in which the portion of the asset is disposed of by the taxpayer. This election may not be made or revoked by the filing of an application for a change in method of accounting. A taxpayer may revoke a partial disposition election by filing a request for a letter ruling and obtaining the consent of the Commissioner of Internal Revenue to revoke this election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. In deciding whether to grant such a request, the Commissioner anticipates applying standards similar to the standards under § 301.9100–3 of this chapter for granting extensions of time for making regulatory elections. If a taxpayer chooses to apply these final regulations to its taxable year beginning in 2012 or 2013, these final regulations also provide rules for making the partial disposition election for the portion of an asset disposed of by the taxpayer during those taxable years.

The final regulations also provide a special partial disposition rule to address the effect of an IRS disallowance of a taxpayer’s characterization of the replacement of a portion of an asset as a repair. When the IRS disallows a taxpayer’s repair deduction for the amount paid or incurred for the replacement of a portion of an asset and capitalizes such amount under § 1.263(a)–2 or § 1.263(a)–3, the taxpayer may make the partial disposition election for the disposition of the portion of the asset to which the IRS’s adjustment pertains by filing an application for change in accounting method, provided the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change (as defined for purposes of section 446(e)).

D. Gain or loss

The final regulations also retain the rules in the 2013 proposed regulations for determining gain or loss upon the disposition of MACRS property. These rules are generally consistent with the disposition rules under § 1.168–6 of the proposed regulations on the Accelerated Cost Recovery System of former section 168 (ACRS) (which generally have been applied to MACRS property). If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss is recognized under the applicable provisions of the Code. If an asset is disposed of by physical abandonment, loss is recognized in the amount of the asset’s adjusted depreciable basis at the time of the abandonment, unless an abandoned asset is subject to nonrecourse indebtedness in which case the asset is treated in the same manner as an asset disposed of by sale. Finally, if an asset is disposed of other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use (for example, when the asset is transferred to a supplies or scrap account), gain is not recognized but loss is recognized in the amount of the excess of the asset’s adjusted depreciable basis over its fair market value at the time of disposition. The same rules apply when the partial disposition rule applies to a disposition of a portion of an asset.

E. Determination of basis of disposed asset

The final regulations retain the rule in the 2013 proposed regulations on determining the unadjusted depreciable basis of a disposed asset if that asset is in a multiple asset account and it is impracticable from the taxpayer’s records to determine the unadjusted depreciable basis of the disposed asset. In such a situation, the final regulations provide that the taxpayer may use any reasonable method that is consistently applied to all assets in the same multiple asset account. The IRS and the Treasury Department expect that reasonable methods are available that use information readily available or known to the taxpayer and do not necessitate undertaking an expensive study.

These final regulations also provide nonexclusive examples of reasonable methods. These examples are the same examples in the 2013 proposed regulations, except that the final regulations do not include discounting the cost of the replacement asset by the Consumer Price Index as an example of a reasonable method. After further review, the IRS and the Treasury Department have determined that the Producer Price Index for Finished Goods (and its successor, the Producer Price Index for Final Demand) more accurately reflects inflation for capital expenditures. The final regulations also clarify that discounting the cost of the replacement asset using the Producer Price Index for Finished Goods is a reasonable method only if the replacement asset is a restoration under § 1.263(a)–3(k) and is not a betterment under § 1.263(a)–3(j) or is not an adaptation to a new or different use under § 1.263(a)–3(l). The examples in the final regulations include the following: (1) discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of the chapter) for purposes of the final regulations) where the replacement asset is a restoration under § 1.263(a)–3(k) and is not a betterment under § 1.263(a)–3(j) or is not an adaptation to a new or different use under § 1.263(a)–3(l); (2) a pro rata allocation of the unadjusted depreciable basis of the multiple asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in
the multiple asset account; and (3) a study allocating the cost of the asset to its individual components.

The final regulations also provide rules to determine the unadjusted depreciable basis of the disposed portion of an asset when the partial disposition rule applies. While these rules retain most of the rules in the 2013 proposed regulations, the final regulations were changed to clarify when a taxpayer may use a reasonable method for determining the unadjusted depreciable basis of a disposed portion of an asset. The IRS and the Treasury Department intended to allow taxpayers to use a reasonable method under the same circumstances as described above for determining the unadjusted depreciable basis of a disposed asset in a multiple asset account. However, the 2013 proposed regulations did not reflect this intent. Consequently, the final regulations clarify that a taxpayer may use any reasonable method for determining the unadjusted depreciable basis of the disposed portion of the asset only if it is impracticable from the taxpayer’s records to determine such unadjusted depreciable basis. If a taxpayer disposes of more than one portion of the same asset and it is impracticable from the taxpayer’s records to determine the unadjusted depreciable basis of the first disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all portions of the same asset for purposes of determining the unadjusted depreciable basis of each disposed portion of the asset. If the asset, a portion of which is disposed of, is in a multiple asset account, the reasonable method used by the taxpayer must be consistently applied to all assets and portions of assets in the same multiple asset account. Finally, the final regulations provide nonexclusive examples of reasonable methods that are similar to those discussed in the preceding paragraph.

F. Identification of disposed asset

The final regulations retain the rules in the 2013 proposed regulations for determining the placed-in-service year of a disposed asset. In general, a taxpayer must use the specific identification method. Under this method, the taxpayer can determine when the asset disposed of was placed in service. If an asset is in a multiple asset account and it is impracticable from the taxpayer’s records to determine the particular year in which the asset was placed in service by the taxpayer, the final regulations allow the taxpayer to identify the asset by using the following: a first-in, first-out (FIFO) method, a modified FIFO method, a mortality dispersion table if the asset is a mass asset, or any other method designated by the Secretary in published guidance. A last-in, first-out (LIFO) method is not permitted. These rules also apply when the partial disposition rule applies to a disposition of a portion of an asset and it is impracticable from the taxpayer’s records to determine the particular taxable year in which the asset was placed in service by the taxpayer. The final regulations provide an additional example of the LIFO method, which is impermissible.

III. General Asset Accounts Under § 1.168(i)–1

Section 168(i)(4) provides that, under regulations, a taxpayer may maintain one or more general asset accounts for any MACRS property. Except as provided in regulations, all proceeds realized on any disposition of property in a general asset account shall be included in income as ordinary income.

The final regulations generally retain all of the provisions in the 2013 proposed regulations for general asset accounts. The final regulations apply only to assets for which the taxpayer has made an election to account for the assets in general asset accounts. Each general asset account effectively is treated as the asset.

A. Establishing general asset accounts

The final regulations retain the rules in the 2013 proposed regulations for establishing general asset accounts. The final regulations provide that assets may be grouped into one or more general asset accounts. In general, each general asset account must include assets that have the same depreciation method, recovery period, and convention, and are placed in service in the same taxable year. However and as provided in the 2013 proposed regulations, the final regulations provide special rules in certain circumstances for establishing general asset accounts. For example, assets eligible for the additional first year depreciation deduction cannot be grouped with assets ineligible for the additional first year depreciation deduction. Also, assets eligible for the additional first year depreciation deduction may be grouped only with assets eligible for the same percentage of the additional first year depreciation.

B. Depreciation of a general asset account

The final regulations retain the rules in the 2013 proposed regulations for determining depreciation for each general asset account. The final regulations explain how to determine depreciation for a general asset account when all the assets in the account are eligible for the additional first year depreciation deduction and when all the assets in the account are not eligible for that deduction.

C. Disposition of an asset from a general asset account

1. Disposition Definition

The final regulations retain the definition of “disposition” that is set forth in the 2013 proposed regulations. This definition is the same as the definition of “disposition” that was previously discussed under the disposition rules for MACRS property under § 1.168(i)–8. That is, a disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset.

A disposition also includes the retirement of a structural component (or a portion thereof) of a building only if the partial disposition rule (discussed in III.C.4) applies to such structural component (or a portion thereof). Finally, the manner of disposition (for example, abnormal retirement or normal retirement) is not taken into consideration in determining whether a disposition occurs or gain or loss is recognized.

2. Determining the Appropriate Disposed Asset

The final regulations also retain the rules in the 2013 proposed regulations for determining the disposed asset included in a general asset account for tax disposition purposes. These rules are the same as those previously discussed for determining the disposed asset for purposes of § 1.168(i)–8.

In general, the facts and circumstances of each disposition are considered in de-
terminating the appropriate disposed asset included in a general asset account. However, the asset for tax disposition purposes may not consist of items placed in service by the taxpayer on different dates (without taking into account the applicable convention under section 168(d)). Further, the unit of property as determined under § 1.263(a)-(3)(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) does not apply for purposes of determining what is the appropriate disposed asset.

In addition to these general rules, the final regulations retain the special rules in the 2013 proposed regulations for certain types of properties. These special rules are the same as the previously discussed special rules for determining the appropriate disposed asset under § 1.168(i)-8. The final regulations provide special rules for determining the appropriate disposed asset that is included in a general asset account and that is: (a) a building (including its structural components); (b) a building that includes two or more condominium or cooperative units; (c) an item properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87-56 (1987-2 CB 674) or classified in one of the categories under section 168(e)(3) (other than a category that includes buildings or structural components; for example, retail motor fuels outlet and qualified leasehold improvement property); or (d) an improvement or addition to an existing asset.

3. Disposition Rules

The final regulations retain the disposition rules in the 2013 proposed regulations. Immediately before any disposition of an asset (or a portion thereof) in a general asset account, the final regulations provide that the asset (or a portion thereof) is treated as having an adjusted depreciable basis of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of the asset (or a portion thereof). The final regulations also provide that any amount realized on a disposition generally is recognized as ordinary income. Further, the final regulations provide that the unadjusted depreciable basis and depreciation reserve of the general asset account are not affected by the disposition. Accordingly, a taxpayer continues to depreciate the general asset account, including the disposed asset (or a portion thereof), as though no disposition occurred.

The final regulations also allow a taxpayer to terminate general asset account treatment upon certain dispositions. Under the final regulations, a taxpayer may elect to recognize gain or loss for a general asset account when the taxpayer disposes of all of the assets, the last asset, or the remaining portion of the last asset in the account.

The final regulations further allow a taxpayer to elect to terminate general asset account treatment for an asset in a general asset account when the taxpayer disposes of the asset in a qualifying disposition. A qualifying disposition is a disposition that does not involve all the assets, the last asset, or the remaining portion of the last asset, remaining in a general asset account and that is: (1) a direct result of a fire, storm, shipwreck, or other casualty, or from theft; (2) a charitable contribution for which a deduction is allowable under section 170; (3) a direct result of a cessation, termination, or disposition of a business, manufacturing, or other income producing process, operation, facility, plant, or other unit (other than by transfer to a supplies, scrap, or similar account); or (4) generally a transaction to which a nonrecognition section of the Code applies. If a taxpayer elects to terminate general asset account treatment for an asset disposed of in a qualifying disposition, the taxpayer must remove the disposed asset from the general asset account and adjust the unadjusted depreciable basis and depreciation reserve of the account.

The final regulations retain the rules in the 2013 proposed regulations on the manner of making (1) the election to terminate the general asset account upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in that general asset account, or (2) the qualifying disposition election. The final regulations provide that a taxpayer making either of these elections must apply section 280B and § 1.280B-1 to determine whether and to what extent gain or loss is recognized. Generally, a taxpayer makes these elections by reporting the gain, loss, or other deduction on the taxpayer’s timely filed original Federal tax return (including extensions) for the taxable year in which the disposition occurs.

In the case of a loss sustained on account of the demolition of a structure to which section 280B and § 1.280B-1 apply, however, the loss is capitalized to the land on which the demolished structure was located, and no gain or loss is reported at the time of demolition. Nevertheless, a taxpayer generally will report a depreciation deduction for the demolished structure for the taxable year in which the demolition occurs. Accordingly, the final regulations clarify that a taxpayer makes the election to terminate the general asset account or the qualifying disposition election by ending depreciation for the demolished structure at the time of disposition (taking into account the applicable convention and reporting the depreciation amount for that structure for the taxable year in which the disposition occurs on the taxpayer’s timely filed original Federal tax return (including extensions) for that taxable year.

For assets in general asset accounts, the final regulations also require a taxpayer to terminate general asset account treatment for an asset that is disposed of in a transaction subject to section 167(i)(7)(B), section 1031, or section 1033, disposed of in an abusive transaction described under the final regulations, or used for any personal use. In such a case, the taxpayer must remove the disposed asset from the general asset account and adjust the unadjusted depreciable basis and depreciation reserve of the account.

In addition, the final regulations require a partnership to terminate its general asset accounts upon the technical termination of the partnership under section 708(b)(1)(B). If there is a redetermination of basis of an asset in a general asset account (for example, due to contingent purchase price or discharge of indebtedness), the final regulations provide that the general asset account election for the asset also applies to the increase or decrease in basis and require the taxpayer to establish a new general asset account for that increase or decrease in basis.

4. Partial Dispositions

The final regulations retain the partial disposition rule in the 2013 proposed regulations. Similar to the partial disposition rule under § 1.168(i)-8 that was previously discussed, the disposition rules in § 1.168(i)-1 apply to a partial disposition
of an asset included in a general asset account. Consequently, a disposition includes a disposition of a portion of an asset as a result of a casualty event described in section 165, a disposition of a portion of an asset for which gain (determined without regard to section 1245 or 1250) is not recognized in whole or in part under section 1031 or 1033, a transfer of a portion of an asset in a transaction described in section 168(i)(7)(B), a sale of a portion of an asset, or a disposition of a portion of an asset in a transaction described under the anti-abuse rules applicable to general asset accounts. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the election to terminate the general asset account upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in that general asset account or makes the qualifying disposition election for that disposed portion. A separate partial disposition election is not provided for assets in a general asset account because a taxpayer can claim a loss upon the disposition of an asset (or a portion thereof) in a general asset account only when the taxpayer makes either one of these two elections.

D. Determination of basis of disposed asset

The final regulations generally retain the rules in the 2013 proposed regulations on determining the unadjusted depreciable basis of an asset for which general asset account treatment is terminated. Because the general asset account is the asset, the final regulations provide that a taxpayer may use any reasonable method that is consistently applied to all assets in the same general asset account to determine the unadjusted depreciable basis of a disposed asset in that account if it is impracticable from the taxpayer’s records to determine the unadjusted depreciable basis of that asset. This rule also applies when the partial disposition rule applies to a disposition of a portion of an asset included in a general asset account. The IRS and the Treasury Department expect that reasonable methods are available that use information readily available or known to the taxpayer and do not necessitate undertaking an expensive study.

These final regulations also provide nonexclusive examples of reasonable methods. These examples are the same examples in the 2013 proposed regulations, except the final regulations do not include the Consumer Price Index as an example of a reasonable method for the reason previously discussed in II.E. Similar to the rules for determining the unadjusted depreciable basis of a disposed asset under § 1.168(i)–8, the final regulations clarify that, when discounting the cost of the replacement asset, using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand) is a reasonable method.

The examples in the final regulations include the following: (1) discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods (or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of the chapter) only if the replacement asset is a restoration under § 1.263(a)–3(k) and is not a betterment under § 1.263(a)–3(j) or is not an adaptation to a new or different use under § 1.263(a)–3(l); (2) a pro rata allocation of the unadjusted depreciable basis of the general asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the general asset account; and (3) a study allocating the cost of the asset to its individual components.

E. Identification of disposed asset

The final regulations retain the rules in the 2013 proposed regulations for determining the placed-in-service year of an asset for which general asset account treatment is terminated. These rules are the same as those previously discussed for identifying the placed-in-service year of the disposed asset for purposes of § 1.168(1)–8: the specific identification method, the FIFO method, the modified FIFO method, a mortality dispersion table if the asset is a mass asset, or any other method designated by the Secretary in published guidance. A LIFO method is not permitted. These rules also apply when the partial disposition rule applies to a disposition of a portion of an asset included in a general asset account. The final regulations provide an additional example of the LIFO method, which is impermissible.

IV. Accounting for MACRS Property Under § 1.168(i)–7

The final regulations retain the rule in the 2013 proposed regulations regarding how to account for a disposed portion of an asset. The final regulations under § 1.168(i)–8 provide that if a taxpayer disposes of a portion of an asset and the partial disposition rule applies to that disposition, the taxpayer must account for the disposed portion in a single asset account beginning in the taxable year in which the disposition occurs. This rule also is provided in the final regulations under § 1.168(i)–7.

V. Conforming Changes

The final regulations also amend §§ 1.165–2, 1.168(i)–7, 1.263(a)–3, and 1.1016–3 to replace references to the temporary regulations and the 2013 proposed regulations with references to these final regulations.

VI. Applicability Dates

The final regulations apply to taxable years beginning on or after January 1, 2014. Alternatively, a taxpayer may choose to apply the final regulations to taxable years beginning on or after January 1, 2012. A taxpayer also may choose to rely on the provisions of the 2013 proposed regulations for taxable years beginning on or after January 1, 2012, and beginning before January 1, 2014. Finally, a taxpayer may choose to apply the temporary regulations to taxable years beginning on or after January 1, 2012, and beginning before January 1, 2014.

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 also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the 2013 proposed regulations preceding this regulation were submitted to the Chief Counsel for Advocacy of the
Small Business Administration for comment on their impact on small business, and no comments were received.

Statement of Availability for IRS Document


Drafting Information

The principal author of these regulations is Kathleen Reed, Office of the 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 is revised by adding an entry for § 1.168(i)–1 to read as follows:

Authority: 26 U.S.C. 7805 * * *
Section 1.168(i)–1 also issued under 26 U.S.C. 168(i)(4).

Par. 2. Section 1.165–2 is amended by revising the first sentence in paragraph (c) to read as follows:

§ 1.168(i)–0 Table of contents for the general asset account rules.

§ 1.168(i)–1 General asset accounts.

(a) Scope. This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (l) of this section.

(b) Definitions. For purposes of this section, the following definitions apply:

(1) Conversion to any personal use.
(2) Portion of an asset.
(3) Remaining adjusted depreciable basis of the general asset account.
(4) Building.
(5) Mass assets.
(6) Building.
(7) Portion of an asset.
(8) Remaining adjusted depreciable basis of the general asset account.
(9) Structural component.
(10) Examples.
(11) Effective/applicability dates.

§ 1.168(i)–2 Obsolescence of nondepreciable property.

(a) Cross references. For the allowance under section 165(a) of losses arising from the permanent withdrawal of depreciable property from use in the trade or business or in the production of income, see § 1.167(a)–8, § 1.168(i)–1, or § 1.168(i)–8, as applicable. *

Par. 3. Section 1.168(i)–0 is amended by:

(a) Redesignating the entries for paragraphs (b)(4), (5), and (6) as paragraphs (b)(5), (6), and (7), respectively, and revising newly redesignated paragraphs (b)(6) and (7).
(b) Adding entries for paragraphs (b)(4), (b)(8), and (b)(9).
(c) Revising entries for paragraphs (c)(3), (d)(2), (d)(3), (e), (e)(1), (e)(2)(v) through (viii), (e)(3)(vi), (h)(1), (i), and (m).
(d) Adding entries for paragraphs (e)(1)(i) and (ii).
(e) Removing the entry for paragraph (h)(2) and redesignating the entry for paragraph (h)(3) as paragraph (h)(2).

The additions and revisions read as follows:

§ 1.168(i)–1 General asset accounts.

(b) * * *
(4) Building.
(6) Mass assets.
(7) Portion of an asset.
(8) Remaining adjusted depreciable basis of the general asset account.
(9) Structural component.
(10) Examples.
(11) Effective/applicability dates.

Par. 3. Section 1.168(i)–0 is amended by:

(a) Redesignating the entries for paragraphs (b)(4), (5), and (6) as paragraphs (b)(5), (6), and (7), respectively, and revising newly redesignated paragraphs (b)(6) and (7).
(b) Adding entries for paragraphs (b)(4), (b)(8), and (b)(9).
(c) Revising entries for paragraphs (c)(3), (d)(2), (d)(3), (e), (e)(1), (e)(2)(v) through (viii), (e)(3)(vi), (h)(1), (i), and (m).
(d) Adding entries for paragraphs (e)(1)(i) and (ii).
(e) Removing the entry for paragraph (h)(2) and redesignating the entry for paragraph (h)(3) as paragraph (h)(2).

The additions and revisions read as follows:

§ 1.168(i)–0 Table of contents for the general asset account rules.

§ 1.168(i)–1 General asset accounts.

(a) Scope. This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (l) of this section.

(b) Definitions. For purposes of this section, the following definitions apply:

(1) Conversion to any personal use.
(2) Portion of an asset.
(3) Remaining adjusted depreciable basis of the general asset account.
(4) Building.
(5) Mass assets.
(6) Building.
(7) Portion of an asset.
(8) Remaining adjusted depreciable basis of the general asset account.
(9) Structural component.
(10) Examples.
(11) Effective/applicability dates.

Par. 5. Section 1.168(i)–1 is amended by revising paragraphs (a) through (l)(1), and (m) to read as follows:

§ 1.168(i)–1 General asset accounts.

(a) Scope. This section provides rules for general asset accounts under section 168(i)(4). The provisions of this section apply only to assets for which an election has been made under paragraph (l) of this section.

(b) Definitions. For purposes of this section, the following definitions apply:

(1) Unadjusted depreciable basis has the same meaning given such term in § 1.168(b)–1(a)(3).

(2) Unadjusted depreciable basis of the general asset account is the sum of the unadjusted depreciable bases of all assets included in the general asset account.

(3) Adjusted depreciable basis of the general asset account is the unadjusted depreciable basis of the general asset account less the adjustments to basis described in section 1016(a)(2) and (3).

(4) Building has the same meaning as that term is defined in § 1.148–1(e)(1).

(5) Expensed cost is the amount of any allowable credit or deduction treated as a deduction allowable for depreciation or amortization for purposes of section 1245 (for example, a credit allowable under section 30 or a deduction allowable under section 179, section 179A, or section 190). Expensed cost does not include any additional first year depreciation deduction.

(6) Mass assets is a mass or group of individual items of depreciable assets.
(i) That are not necessarily homogenous;
(ii) Each of which is minor in value relative to the total value of the mass or group;
(iii) Numerous in quantity;
(iv) Usually accounted for only on a total dollar or quantity basis;
(v) With respect to which separate identification is impracticable; and
(vi) Placed in service in the same taxable year.

(7) Portion of an asset is any part of an asset that is less than the entire asset as determined under paragraph (e)(2)(viii) of this section.

(8) Remaining adjusted depreciable basis of the general asset account is the unadjusted depreciable basis of the general asset account less the amount of the additional first year depreciation deduction allowed or allowable, whichever is greater, for the general asset account.

(9) Structural component has the same meaning as that term is defined in § 1.48–1(e)(2).

(c) Establishment of general asset accounts—(i) Assets eligible for general asset accounts—(i) General rules. Assets that are subject to either the general depreciation system of section 168(a) or the alternative depreciation system of section 168(g) may be accounted for in one or more general asset accounts. An asset is included in a general asset account only to the extent of the asset’s unadjusted depreciable basis. However, an asset is not to be included in a general asset account if the asset is used both in a trade or business or for the production of income and in a personal activity at any time during the taxable year in which the asset is placed in service by the taxpayer or if the asset is placed in service and disposed of during the same taxable year.

(ii) Special rules for assets generating foreign source income. (A) Assets that generate foreign source income, both United States and foreign source income, or combined gross income of a foreign sales corporation (as defined in former section 922), domestic international sales corporation (as defined in section 992(a)), or possession corporation (as defined in section 936) and its related supplier may be included in a general asset account if the requirements of paragraph (c)(2)(i) of this section are satisfied. If, however, the inclusion of these assets in a general asset account results in a substantial distortion of income, the Commissioner may disregard the general asset account election and make any reallocations of income or expense necessary to clearly reflect income.

(B) A general asset account shall be treated as a single asset for purposes of applying the rules in § 1.861–9T(g)(3) (relating to allocation and apportionment of interest expense under the asset method). A general asset account that generates income in more than one grouping of income (statutory and residual) is a multiple category asset (as defined in § 1.861–9T(g)(3)(ii)), and the income yield from the general asset account must be determined by applying the rules for multiple category assets as if the general asset account were a single asset. c-accounts—(i) General rules. If a taxpayer makes the election under paragraph (l) of this section, assets that are subject to the election are grouped into one or more general asset accounts. Assets that are eligible to be grouped into a single general asset account may be divided into more than one general asset account. Each general asset account must include only assets that—

(A) Have the same applicable depreciation method;
(B) Have the same applicable recovery period;
(C) Have the same applicable convention; and
(D) Are placed in service by the taxpayer in the same taxable year.

(ii) Special rules. In addition to the general rules in paragraph (c)(2)(i) of this section, the following rules apply when establishing general asset accounts—

(A) Assets subject to the mid-quarter convention may only be grouped into a general asset account with assets that are placed in service in the same quarter of the taxable year;

(B) Assets subject to the mid-month convention may only be grouped into a general asset account with assets that are placed in service in the same month of the taxable year;

(C) Passenger automobiles for which the depreciation allowance is limited under section 280F(a) must be grouped into a separate general asset account;

(D) Assets not eligible for any additional first year depreciation deduction (including assets for which the taxpayer elected not to deduct the additional first year depreciation) provided by, for example, section 168(k), section 168(l), section 168(m), section 168(n), section 1400L(b), or section 1400N(d), must be grouped into a separate general asset account;

(E) Assets eligible for the additional first year depreciation deduction may only be grouped into a general asset account with assets for which the taxpayer claimed the same percentage of the additional first year depreciation (for example, 30 percent, 50 percent, or 100 percent);

(F) Except for passenger automobiles described in paragraph (c)(2)(ii)(C) of this section, listed property (as defined in section 280F(d)(4)) must be grouped into a separate general asset account;

(G) Assets for which the depreciation allowance for the placed-in-service year is not determined by using an optional depreciation table (for further guidance, see section 8 of Rev. Proc. 87–57, 1987–2 CB 687, 693 (see § 601.601(d)(2) of this chapter)) must be grouped into a separate general asset account;

(H) Mass assets that are or will be subject to paragraph (j)(2)(i)(D) of this section (disposed of or converted mass asset is identified by a mortality dispersion table) must be grouped into a separate general asset account; and

(I) Assets subject to paragraph (h)(2)(iii)(A) of this section (change in use results in a shorter recovery period or a more accelerated depreciation method) for which the depreciation allowance for the year of change (as defined in § 1.168(i)–4(a)) is not determined by using an optional depreciation table must be grouped into a separate general asset account.

(3) Examples. The following examples illustrate the application of this paragraph (c): Example 1. In 2014, J, a proprietorship with a calendar year-end, purchases and places in service one item of equipment that costs $550,000. This equipment is section 179 property and also is 5-year property under section 168(e). On its Federal tax return for 2014, J makes an election under section 179 to expense $25,000 of the equipment’s cost and makes an election under paragraph (l) of this section to include the equipment in a general asset account. As a result, the unad-
justed depreciable basis of the equipment is $525,000. In accordance with paragraph (c)(1) of this section, J must include only $525,000 of the equipment’s cost in the general asset account.

Example 2. In 2014, K, a proprietorship with a calendar year-end, purchases and places in service 100 items of equipment. All of these items are 5-year property under section 168(e), are not listed property, and are not eligible for any additional first year depreciation deduction. On its Federal tax return for 2014, K does not make an election under section 179 to expense the cost of any of the 100 items of equipment and does make an election under paragraph (l) of this section to include all of these items of equipment in a general asset account. K depreciates its 5-year property placed in service in 2014 using the optional depreciation table. The computer is subject to depreciation for the placed-in-service year is de-

Example 3. The facts are the same as in Example 2, except that K decides not to include all of the 100 items of equipment in one general asset account. Instead and in accordance with paragraph (c)(2) of this section, K establishes 100 general asset accounts and includes one item of equipment in each general asset account.

Example 4. L, a calendar-year corporation, is a wholesale distributor. In 2014, L places in service the following properties for use in its wholesaler distribution business: computers, automobiles, and forklifts. On its Federal tax return for 2014, L does not make an election under section 179 to expense the cost of any of these items of equipment and does make an election under paragraph (l) of this section to include all of these items of equipment in a general asset account. All of these items are 5-year property under section 168(e) and are not eligible for any additional first year depreciation deduction. The computers are listed property, and the automobiles are listed property and are subject to section 280F(a). L depreciates its 5-year property placed in service in 2014 using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the half-year convention. In accordance with paragraph (c)(2) of this section, L establishes one general asset account for the placed-in-service year and then must determine the amount otherwise allowable for the additional first year depreciation deduction. In accordance with paragraph (c)(2) of this section, L establishes two general asset accounts: one for the ten items of equipment eligible for the 50-percent additional first year depreciation deduction and one for the five items of equipment not eligible for any additional first year depreciation deduction.

(d) Determination of depreciation allowance—(1) In general. Depreciation allowances are determined for each general asset account. The depreciation allowances must be recorded in a depreciation reserve account for each general asset account. The allowance for depreciation under this section constitutes the amount of depreciation allowable under section 167(a).

(2) Assets in general asset account are eligible for additional first year depreciation deduction. If all the assets in a general asset account are eligible for the additional first year depreciation deduction, the taxpayer first must determine the allowable additional first year depreciation deduction for the general asset account for the placed-in-service year and then must determine the amount otherwise allowable as a depreciation deduction for the general asset account for the placed-in-service year and any subsequent taxable year. The allowable additional first year depreciation deduction for the general asset account for the placed-in-service year is determined by multiplying the unadjusted depreciable basis of the general asset ac-

(3) No assets in general asset account are eligible for additional first year depreciation deduction. If none of the assets in a general asset account are eligible for the additional first year depreciation deduction, the taxpayer must determine the allowable depreciation deduction for the general asset account for the placed-in-service year and any subsequent taxable year by using the applicable depreciation method, recovery period, and convention for the assets in the account.

(4) Special rule for passenger automobiles. For purposes of applying section 280F(a), the depreciation allowance for a general asset account established for passenger automobiles is limited for each taxable year to the amount prescribed in section 280F(a) multiplied by the excess of the number of automobiles originally included in the account over the number of automobiles disposed of during the taxable year or in any prior taxable year in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(iv) (transactions subject to section 168(k)(7)), paragraph (e)(3)(v) (transactions subject to section 1031 or section 1033), paragraph (e)(3)(vi) (technical termination of a partnership), paragraph (e)(3)(vii) (anti-abuse rule), paragraph (g) (assets subject to recapture), or paragraph (h)(1) (conversion to any personal use) of this section.

(e) Dispositions from a general asset account—(1) Scope and definition—(i) In general. This paragraph (e) provides rules applicable to dispositions of assets included in a general asset account. For purposes of this paragraph (e), an asset in a general asset account is disposed of when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A dispo-
sition also occurs when an asset is transferred to a supplies, scrap, or similar account, or when a portion of an asset is disposed of as described in paragraph (e)(1)(ii) of this section. If a structural component, or a portion thereof, of a building is disposed of in a disposition described in paragraph (e)(1)(ii) of this section, a disposition also includes the disposition of such structural component or such portion thereof.

(ii) Disposition of a portion of an asset. For purposes of applying paragraph (e) of this section, a disposition includes a disposition of a portion of an asset in a general asset account as a result of a casualty event described in section 165, a disposition of a portion of an asset in a general asset account for which gain, determined without regard to section 1245 or section 1250, is not recognized in whole or in part under section 1031 or section 1033, a transfer of a portion of an asset in a general asset account in a transaction described in section 168(ii)(7)(B), a sale of a portion of an asset in a general asset account, or a disposition of a portion of an asset in a general asset account in a transaction described in paragraph (e)(3)(vii)(B) of this section. For other transactions, a disposition includes a disposition of a portion of an asset in a general asset account only if the taxpayer makes the election under paragraph (e)(3)(ii) of this section to terminate the general asset account in which that disposed portion is included or makes the election under paragraph (e)(3)(iii) of this section for that disposed portion.

(2) General rules for a disposition—(i) No immediate recovery of basis. Except as provided in paragraph (e)(3) of this section, immediately before a disposition of any asset in a general asset account or a disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section, the asset or the portion of the asset, as applicable, is treated as having an adjusted depreciable basis (as defined in § 1.168(b)–1(a)(4)) of zero for purposes of section 1011. Therefore, no loss is realized upon the disposition of an asset from the general asset account or upon the disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section. Similarly, where an asset or a portion of an asset, as applicable, is disposed of by transfer to a supplies, scrap, or similar account, the basis of the asset or the portion of the asset, as applicable, in the supplies, scrap, or similar account will be zero.

(ii) Treatment of amount realized. Any amount realized on a disposition is recognized as ordinary income, notwithstanding any other provision of subtitle A of the Internal Revenue Code (Code), to the extent the sum of the unadjusted depreciable basis of the general asset account and any expenses cost (as defined in paragraph (b)(5) of this section) for assets in the account exceeds any amounts previously recognized as ordinary income upon the disposition of other assets in the account or upon the disposition of portions of such assets as described in paragraph (e)(1)(ii) of this section. The recognition and characteristic of any excess amount realized are determined under other applicable provisions of the Code other than sections 1245 and 1250 or provisions of the Code that treat gain on a disposition as subject to section 1245 or section 1250.

(iii) Effect of disposition on a general asset account. Except as provided in paragraph (e)(3) of this section, the unadjusted depreciable basis and the depreciation reserve of the general asset account are not affected as a result of a disposition of an asset from the general asset account or of a disposition of a portion of such asset as described in paragraph (e)(1)(ii) of this section.

(iv) Coordination with nonrecognition provisions. For purposes of determining the basis of an asset or a portion of an asset, as applicable, acquired in a transaction, other than a transaction described in paragraph (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), paragraph (e)(3)(v) (pertaining to transactions subject to section 1031 or section 1033), and paragraph (e)(3)(vi) (pertaining to technical terminations of partnerships) of this section, to which a nonrecognition section of the Code applies, determined without regard to this section, the amount of ordinary income recognized under this paragraph (e)(2) is treated as the amount of gain recognized on the disposition.

(v) Manner of disposition. The manner of disposition (for example, normal retirement, abnormal retirement, ordinary retirement, or extraordinary retirement) is not taken into account in determining whether a disposition occurs or gain or loss is recognized.

(vi) Disposition by transfer to a supplies account. If a taxpayer made an election under § 1.162–3(d) to treat the cost of any rotatable spare part, temporary spare part, or standby emergency spare part (as defined in § 1.162–3(c)) as a capital expenditure subject to the allowance for depreciation and also made an election under paragraph (l) of this section to include that rotatable, temporary, or standby emergency spare part in a general asset account, the taxpayer can dispose of the rotatable, temporary, or standby emergency spare part by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the § 1.162–3(d) election. If a taxpayer made an election under § 1.162–3T(d) to treat the cost of any material and supply (as defined in § 1.162–3T(c)(1)) as a capital expenditure subject to the allowance for depreciation and also made an election under paragraph (l) of this section to include that material and supply in a general asset account, the taxpayer can dispose of the material and supply by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the § 1.162–3T(d) election. See § 1.162–3T(d)(3) for the procedures for revoking a § 1.162–3T(d) election.

(vii) Leasehold improvements. The rules of paragraph (e) of this section also apply to—

(A) A lessor of leased property that made an improvement to that property for the lessee of the property, has a depreciable basis in the improvement, made an election under paragraph (l) of this section to include the improvement in a general asset account, and disposes of the improvement, or disposes of a portion of the improvement as described in paragraph (e)(1)(ii) of this section, before or upon the termination of the lease with the lessee. See section 168(i)(8)(B); and

(B) A lessee of leased property that made an improvement to that property, has a depreciable basis in the improvement, made an election under paragraph (l) of this section to include the improvement in a general asset account, and disposes of the improvement, or disposes of
a portion of the improvement as described in paragraph (e)(1)(ii) of this section, before or upon the termination of the lease.

(viii) Determination of asset disposed of—(A) General rules. For purposes of applying paragraph (e) of this section to the disposition of an asset in a general asset account, instead of the disposition of the general asset account, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The asset for disposition purposes may not consist of items placed in service by the taxpayer on different dates, without taking into account the applicable convention. For purposes of determining what is the appropriate asset disposed of, the unit of property determined under § 1.263(a)–3(e) or in published guidance in the Internal Revenue Bulletin under section 263(a) (see § 601.601(d)(2) of this chapter) does not apply.

(B) Special rules. In addition to the general rules in paragraph (e)(2)(viii)(A) of this section, the following rules apply for purposes of applying paragraph (e) of this section to the disposition of an asset in a general asset account instead of the disposition of the general asset account:

(1) Each building, including its structural components, is the asset, except as provided in § 1.1250–1(a)(2)(ii) or in paragraph (e)(2)(viii)(B)(2) or (4) of this section.

(2) If a building has two or more condominium or cooperative units, each condominium or cooperative unit, including its structural components, is the asset, except as provided in § 1.1250–1(a)(2)(ii) or in paragraph (e)(2)(viii)(B)(4) of this section.

(3) If a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56 (1987–2 CB 674) (see § 601.601(d)(2) of this chapter) or properly classifies an item in one of the categories under section 168(e)(3), except for a category that includes buildings or structural components (for example, retail motor fuels outlet, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property), each item is the asset, provided that paragraph (e)(2)(viii)(B)(4) of this section does not apply to the item. For example, each desk is the asset, each computer is the asset, and each qualified smart electric meter is the asset.

(4) If the taxpayer places in service an improvement or addition to an asset after the taxpayer placed the asset in service, the improvement or addition and, if applicable, its structural components are a separate asset.

(ix) Examples. The following examples illustrate the application of this paragraph (e)(2):

Example 1. A, a calendar-year partnership, maintains one general asset account for one office building that cost $10 million. A discovers a leak in the roof of the building and decides to replace the entire roof. The roof is a structural component of the building. In accordance with paragraph (e)(2)(viii)(B)(1) of this section, the office building, including its structural components, is the asset for disposition purposes. The retirement of the replaced roof is not a disposition of a portion of an asset as described in paragraph (e)(1)(ii) of this section. Thus, the retirement of the replaced roof is not a disposition under paragraph (e)(1) of this section. As a result, A continues to depreciate the $10 million cost of the general asset account. If A must capitalize the amount paid for the replacement roof pursuant to § 1.263(a)–3, the replacement roof is a separate asset for disposition purposes pursuant to paragraph (e)(2)(viii)(B)(4) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 2. B, a calendar-year commercial airline company, maintains one general asset account for five aircraft that cost a total of $50 million. These aircraft are described in asset class 45.0 of Rev. Proc. 87–56. B replaces the existing engines on one of the aircraft with new engines. Assume each aircraft is a unit of property as determined under § 1.263(a)–3(e)(3) and each engine of an aircraft is a major component or substantial structural part of the aircraft as determined under § 1.263(a)–3(k)(6). Assume also that B treats each aircraft as the asset for disposition purposes in accordance with paragraph (e)(2)(viii) of this section. The retirement of the replaced engines is not a disposition of a portion of an asset as described in paragraph (e)(1)(ii) of this section. Thus, the retirement of the replaced engines is not a disposition under paragraph (e)(1) of this section. As a result, B continues to depreciate the $50 million cost of the general asset account. If B must capitalize the amount paid for the replacement engines pursuant to § 1.263(a)–3, the replacement engines are a separate asset for disposition purposes pursuant to paragraph (e)(2)(viii)(B)(4) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 3. (i) R, a calendar-year corporation, maintains one general asset account for ten machines. The machines cost a total of $10,000 and are placed in service in June 2014. Of the ten machines, one machine costs $8,200 and nine machines cost a total of $1,800. Assume R depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. R does not make a section 179 election for any of the machines, and all of the machines are not eligible for any additional first year depreciation deduction. As of January 1, 2015, the depreciation reserve of the account is $2,000 ($10,000 × 20%).

(ii) On February 8, 2015, R sells the machine that cost $8,200 to an unrelated party for $9,000. Under paragraph (e)(2)(ii) of this section, this machine has an adjusted depreciable basis of zero.

(iii) On its 2015 tax return, R recognizes the amount realized of $9,000 as ordinary income because such amount does not exceed the undepreciated basis of the general asset account ($10,000), plus any expensed cost for assets in the account ($0), less amounts previously recognized as ordinary income ($0). Moreover, the undepreciated depreciable basis and depreciation reserve of the account are not affected by the disposition of the machine. Thus, the depreciation allowance for the account in 2015 is $3,200 ($10,000 × 32%).

Example 4. (i) The facts are the same as in Example 3. In addition, on June 4, 2016, R sells seven machines to an unrelated party for a total of $1,100. In accordance with paragraph (e)(2)(ii) of this section, these machines have an adjusted depreciable basis of zero.

(ii) On its 2016 tax return, R recognizes $1,000 as ordinary income (the undepreciated basis of $1,000, plus the expensed cost of $0, less the amount of $9,000 previously recognized as ordinary income). The recognition and character of the excess amount realized of $100 ($1,100–$1,000) are determined under applicable provisions of the Code other than section 1245 (such as section 1231). Moreover, the undepreciable basis and depreciation reserve of the account are not affected by the disposition of the machines. Thus, the depreciation allowance for the account in 2016 is $1,920 ($10,000 × 19.2%).

(3) Special rules—(i) In general. This paragraph (e)(3) provides the rules for terminating general asset account treatment upon certain dispositions. While the rules under paragraphs (e)(3)(ii) and (iii) of this section are optional rules, the rules under paragraphs (e)(3)(iv), (v), (vi), and (vii) of this section are mandatory rules. A taxpayer elects to apply paragraph (e)(3)(ii) or (iii) of this section by reporting the gain, loss, or other deduction on the taxpayer’s timely filed original Federal tax return, including extensions, for the taxable year in which the disposition occurs. However, if the loss is on account of the demolition of a structure to which section 280B and § 1.280B–1 apply, a taxpayer elects to apply paragraph (e)(3)(ii) or (iii) of this section by ending depreciation for the structure at the time of the disposition
of the structure, taking into account the convention applicable to the general asset account in which the demolished structure was included, and reporting the amount of depreciation for that structure for the taxable year in which the disposition occurs on the taxpayer’s timely filed original Federal tax return, including extensions, for that taxable year. A taxpayer may revoke the election to apply paragraph (e)(3)(ii) or (iii) of this section only by filing a request for a private letter ruling and obtaining the Commissioner’s consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. See generally § 301.9100–3 of this chapter. The election to apply paragraph (e)(3)(ii) or (iii) of this section may not be made or revoked through the filing of an application for change in accounting method. For purposes of applying paragraphs (e)(3)(ii) through (vii) of this section, see paragraph (j) of this section for identifying an asset disposed of and its unadjusted depreciable basis. Solely for purposes of applying paragraphs (e)(3)(iii), (e)(3)(iv)(C), (e)(3)(v)(B), and (e)(3)(vii) of this section, the term asset is:

(A) The asset as determined under paragraph (e)(2)(viii) of this section; or

(B) The portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section.

(ii) Disposition of all assets remaining in a general asset account—(A) Optional termination of a general asset account. Upon the disposition of all of the assets, the last asset, or the remaining portion of the last asset in a general asset account, a taxpayer may apply this paragraph (e)(3)(ii) to recover the adjusted depreciable basis of the general asset account rather than having paragraph (e)(2) of this section apply. Under this paragraph (e)(3)(ii), the general asset account terminates and the amount of gain or loss for the general asset account is determined under section 1001(a) by taking into account the adjusted depreciable basis of the general asset account at the time of the disposition, as determined under the applicable convention for the general asset account. Whether and to what extent gain or loss is recognized is determined under other applicable provisions of the Code, including section 280B and § 1.280B–1. The character of the gain or loss is determined under applicable provisions of the Code, except that the amount of gain subject to section 1245 is limited to the excess of the depreciation allowed or allowable for the general asset account, including any expensed cost, over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section, and the amount of gain subject to section 1250 is limited to the excess of the additional depreciation allowed or allowable for the general asset account, over any amounts previously recognized as ordinary income under paragraph (e)(2) of this section.

(B) Examples. The following examples illustrate the application of this paragraph (e)(3)(ii):

Example 1. (i) T, a calendar-year corporation, maintains a general asset account for 1,000 calculators. The calculators cost a total of $60,000 and are placed in service in 2014. Assume T depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and a half-year convention. T does not make a section 179 election for the equipment, and it is not eligible for any additional first year depreciation deduction. In June 2016, T sells the equipment to an unrelated party for $1,000. T elects to apply paragraph (e)(3)(ii) of this section. As a result, the account terminates and gain or loss is determined for the account.

(ii) On the date of disposition, the adjusted depreciable basis of the account is $768 (unadjusted depreciable basis of $2,000 less the depreciation allowed or allowable of $1,232). Thus, in 2016, T recognizes gain of $232 (amount realized of $1,000 less the adjusted depreciable basis of $768). The gain of $232 is subject to section 1245 to the extent of the depreciation allowed or allowable for the account (plus the expensed cost for assets in the account) less the amounts previously recognized as ordinary income ($232 + $0 − $0 = $232). As a result, the entire gain of $232 is subject to section 1245.

(iii) Disposition of an asset in a qualifying disposition—(A) Optional determination of the amount of gain, loss, or other deduction. In the case of a qualifying disposition (described in paragraph (e)(3)(iii)(B) of this section) of an asset, a taxpayer may elect to apply this paragraph (e)(3)(iii) rather than having paragraph (e)(2) of this section apply. Under this paragraph (e)(3)(iii), general asset account treatment for the asset terminates as of the first day of the taxable year in which the qualifying disposition occurs, and the amount of gain, loss, or other deduction for the asset is determined under § 1.1168(i)–8 by taking into account the asset’s adjusted depreciable basis at the time of the disposition. The adjusted depreciable basis of the asset at the time of the disposition, as determined under the applicable convention for the general asset account in which the asset was included, equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the asset disposed of. Whether and to what extent gain, loss, or other deduction is recognized is determined under other applicable provisions of the Code, including section 280B and § 1.280B–1. The character of the gain, loss, or other deduction is determined under other applicable provisions of the Code, except that the amount of gain subject to section
1245 or section 1250 is limited to the lesser of—

(1) The depreciation allowed or allowable for the asset, including any expensed cost or, in the case of section 1250 property, the additional depreciation allowed or allowable for the asset; or

(2) The excess of—

(i) The original unadjusted depreciable basis of the general asset account plus, in the case of section 1245 property originally included in the general asset account, any expensed cost; over

(ii) The cumulative amounts of gain previously recognized as ordinary income under either paragraph (e)(2) of this section or section 1245 or section 1250.

(B) Qualifying dispositions. A qualifying disposition is a disposition that does not involve all the assets, the last asset, or the remaining portion of the last asset remaining in a general asset account and that is—

(1) A direct result of a fire, storm, shipwreck, or other casualty, or from theft;

(2) A charitable contribution for which a deduction is allowable under section 170;

(3) A direct result of a cessation, termination, or disposition of a business, manufacturing or other income producing process, operation, facility, plant, or other unit, other than by transfer to a supplies, scrap, or similar account; or

(4) A transaction, other than a transaction described in paragraph (e)(3)(iv) (pertaining to transactions subject to section 168(i)(7)), paragraph (e)(3)(v) (pertaining to transactions subject to section 1031 or section 1033), paragraph (e)(3)(vi) (pertaining to technical terminations of partnerships), or paragraph (e)(3)(vii) (anti-abuse rule) of this section, to which a nonrecognition section of the Internal Revenue Code applies (determined without regard to this section).

(C) Effect of a qualifying disposition on a general asset account. If the taxpayer elects to apply this paragraph (e)(3)(iii) to a qualifying disposition of an asset, then—

(1) The asset is removed from the general asset account as of the first day of the taxable year in which the qualifying disposition occurs. For that taxable year, the taxpayer accounts for the asset in a single asset account in accordance with the rules under § 1.168(i)–7(b);

(2) The unadjusted depreciable basis of the general asset account is reduced by the unadjusted depreciable basis of the asset as of the first day of the taxable year in which the disposition occurs;

(3) The depreciation reserve of the general asset account is reduced by the depreciation allowed or allowable for the asset as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the asset disposed of; and

(4) For purposes of determining the amount of gain realized on subsequent dispositions that is subject to ordinary income treatment under paragraph (e)(2)(ii) of this section, the amount of any expensed cost with respect to the asset is disregarded.

(D) Examples. The following examples illustrate the application of this paragraph (e)(3)(iii):

Example 1. (i) Z, a calendar-year corporation, maintains one general asset account for 12 machines. Each machine costs $15,000 and is placed in service in 2014. Of the 12 machines, nine machines that cost a total of $135,000 are used in Z’s Kentucky plant, and three machines that cost a total of $45,000 are used in Z’s Ohio plant. Assume Z depreciables this general asset account using the optional depreciation table that corresponds with the general depreciation system, the 200-percent declining balance method, a 5-year recovery period, and the mid-month convention. As of January 1, 2014, the depreciation reserve for the account is $1,261,000.

(ii) On May 27, 2016, Z sells its entire manufacturing plant in Ohio to an unrelated party. The sales proceeds allocated to each of the three machines at the Ohio plant is $5,000. This transaction is a direct result of a fire, storm, shipwreck, or other casualty. Consequently, the sales proceeds allocated to each of the three machines at the Ohio plant is $5,000. This transaction is a direct result of a fire, storm, shipwreck, or other casualty. Consequently, the sales proceeds allocated to each of the three machines at the Ohio plant is $5,000. Thus, as of December 31, 2016, the unadjusted depreciable basis of the account is reduced from $180,000 to $135,000 ($180,000 less the unadjusted depreciable basis of $45,000 for the three machines), and, as of December 31, 2015, the depreciation reserve of the account is decreased from $93,600 to $70,200 ($93,600 less the depreciation allowed or allowable for $25,400 for the three machines as of December 31, 2015). Consequently, the depreciation allowance for the account in 2016 is $25,920 ($135,000 × 19.2%).

(iv) For Z’s 2016 return, gain or loss for each of the three machines at the Ohio plant is determined as follows. The depreciation allowed or allowable in 2016 for each machine is $1,440 (($15,000 × 19.2%)/2). Thus, the adjusted depreciable basis of each machine under section 1011 is $5,760 (the adjusted depreciable basis of $7,200 removed from the account less the depreciation allowed or allowable of $1,440 in 2016). As a result, the loss recognized in 2016 for each machine is $760 ($5,000 – $5,760), which is subject to section 1231.

Example 2. (i) A, a calendar-year partnership, maintains one general asset account for one office building that cost $20 million and was placed in service in July 2011. A depreciates this general asset account using the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 29-year recovery period, and the mid-month convention. As of January 1, 2014, the depreciation reserve for the account is $1,261,000.

(ii) In May 2014, a tornado occurs where the building is located and damages the roof of the building. A decides to replace the entire roof. The roof is replaced in June 2014. The roof is a structural component of the building. Because the roof was damaged as a result of a casualty event described in section 165, the partial disposition rule provided under paragraph (e)(1)(ii) of this section applies to the roof. Although the office building, including its structural components, is the asset for disposition purposes, the partial disposition rule provides that the retirement of the replaced roof is a disposition under paragraph (e)(1) of this section. This retirement is a qualifying disposition under paragraph (e)(3)(iii)(B)(1) of this section, and A elects to apply paragraph (e)(3)(iii) of this section for the retirement of the damaged roof.

(iii) Of the $20 million cost of the office building, assume $1 million is the cost of the retired roof.

(iv) For A’s 2014 return, the depreciation allowance for the account is computed as follows. As of December 31, 2013, the depreciation allowed or allowable for the retired roof is $63,050. Thus, as of January 1, 2014, the unadjusted depreciable basis of the account is reduced from $20,000,000 to $19,000,000 ($20,000,000 less the unadjusted depreciable basis of $1,000,000 for the retired roof), and the depreciation reserve of the account is decreased from $1,261,000 to $1,197,950 ($1,261,000 less the depreciation allowed or allowable of $63,050 for the retired roof as of December 31, 2013). Consequently, the depreciation allowance for the account in 2014 is $548,160 ($19,000,000 × 2.564%).

(v) For A’s 2014 return, gain or loss for the retired roof is determined as follows. The depreciation allowed or allowable in 2014 for the retired roof is $11,752 (($1,000,000 × 2.564%) ×
purposes pursuant to § 1.168(i)–8(c)(4)(ii)(D).

placement roof is a separate asset for disposition purposes pursuant to section 168(i)(6). If A includes the replacement roof in a general asset account, the replacement roof is a separate asset for disposition purposes pursuant to paragraph (e)(2)(vii)(B)(4) of this section. If A includes the replacement roof in a single asset account or a multiple asset account under § 1.168(i)–7, the replacement roof is a separate asset for disposition purposes pursuant to § 1.168(i)–8(c)(4)(ii)(D).

(iv) Transactions subject to section 168(i)(7)—(A) In general. If a taxpayer transfers one or more assets, or a portion of such asset, in a general asset account in a transaction described in section 168(i)(7)(B) (pertaining to treatment of transfers in certain nonrecognition transactions), the taxpayer (the transferor) and the transferee must apply this paragraph (e)(3)(iv) to the asset or the portion of such asset, instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. The transferee is bound by the transferor’s election under paragraph (l) of this section for the portion of the transferee’s basis in the asset or the portion of such asset that does not exceed the transferor’s adjusted depreciable basis of the general asset account or the asset or the portion of such asset, as applicable, as determined under paragraph (e)(3)(iv)(B)(2) or (C)(2) of this section, as applicable.

(B) All assets remaining in general asset account are transferred. If a taxpayer transfers all the assets, the last asset, or the remaining portion of the last asset in a general asset account in a transaction described in section 168(i)(7)(B)—

(1) The taxpayer (the transferor) must terminate the general asset account on the date of the transfer. The allowable depreciation deduction for the general asset account for the transferor’s taxable year in which the section 168(i)(7)(B) transaction occurs is computed by using the depreciation method, recovery period, and convention applicable to the general asset account. This allowable depreciation deduction is allocated between the transferor and the transferee on a monthly basis. This allocation is made in accordance with the rules in § 1.168(d)–1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee;

(2) The transferee must establish a new general asset account for all the assets, the last asset, or the remaining portion of the last asset, in the taxable year in which the section 168(i)(7)(B) transaction occurs for the portion of its basis in the assets that does not exceed the transferor’s adjusted depreciable basis of the general asset account in which all the assets, the last asset, or the remaining portion of the last asset, were included. The transferor’s adjusted depreciable basis of the general asset account is equal to the adjusted depreciable basis of that account as of the beginning of the transferor’s taxable year in which the transaction occurs, decreased by the amount of depreciation allocable to the transferor for the year of the transfer, as determined under paragraph (e)(3)(iv)(B)(1) of this section. The transferee is treated as the transferor for purposes of computing the allowable depreciation deduction for the new general asset account under section 168. The new general asset account must be established in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable basis of the new general asset account is equal to the adjusted depreciable basis of the asset as of the beginning of the transferor’s taxable year in which the section 168(i)(7)(B) transaction occurs and the beginning of the transferee’s taxable year in which the section 168(i)(7)(B) transaction occurs. The transferee is treated as the transferor for purposes of computing the allowable depreciation deduction for the new general asset account.

(C) Not all assets remaining in general asset account are transferred. If a taxpayer transfers an asset in a general asset account in a transaction described in section 168(i)(7)(B) and if paragraph (e)(3)(iv)(B) of this section does not apply to this asset—

(1) The taxpayer (the transferor) must remove the transferred asset from the general asset account in which the asset is included, as of the first day of the taxable year in which the section 168(i)(7)(B) transaction occurs. In addition, the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section must be made. The allowable depreciation deduction for the asset for the transferor’s taxable year in which the section 168(i)(7)(B) transaction occurs is computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included. This allowable depreciation deduction is allocated between the transferor and the transferee on a monthly basis. This allocation is made in accordance with the rules in § 1.168(d)–1(b)(7)(ii) for allocating the depreciation deduction between the transferor and the transferee.

(2) The transferee must establish a new general asset account for the asset in the taxable year in which the section 168(i)(7)(B) transaction occurs for the portion of its basis in the asset that does not exceed the transferor’s adjusted depreciable basis of the asset. The transferor’s adjusted depreciable basis of this asset is equal to the adjusted depreciable basis of the asset as of the beginning of the transferor’s taxable year in which the section 168(i)(7)(B) transaction occurs; decreased by the amount of depreciation allocable to the transferor for the year of the transfer, as determined under paragraph (e)(3)(iv)(B)(1) of this section; and

(3) For purposes of section 168 and this section, the transferee treats the portion of its basis in the assets that exceeds the transferor’s adjusted depreciable basis of the general asset account in which all the assets, the last asset, or the remaining portion of the last asset, were included, as determined under paragraph (e)(3)(iv)(B)(2) of this section, as a separate asset that the transferee placed in service on the date of the transfer. The transferee accounts for this asset under § 1.168(i)–7 or may make an election under paragraph (l) of this section to include the asset in a general asset account.
amount of depreciation for the transferred asset that is allocable to the transferor for the year of the transfer, are included in the newly established general asset account. Consequently, this general asset account in the year of the transfer will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account; and

(3) For purposes of section 168 and this section, the transferee treats the portion of its basis in the asset that exceeds the transferor’s adjusted depreciable basis of the asset, as determined under paragraph (e)(3)(iv)(C)(2) of this section, as a separate asset that the transferee placed in service on the date of the transfer. The transferee accounts for this asset under § 1.168(i)–7 or may make an election under paragraph (l) of this section to include the asset in a general asset account.

(v) Transactions subject to section 1031 or section 1033—(A) Like-kind exchange or involuntary conversion of all assets remaining in a general asset account. If all the assets, the last asset, or the remaining portion of the last asset in a general asset account are transferred by a taxpayer in a like-kind exchange (as defined under § 1.168–6(b)(11)) or in an involuntary conversion (as defined under § 1.168–6(b)(12)), the taxpayer must apply this paragraph (e)(3)(v)(A) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(v)(B), general asset account treatment for the asset terminates as of the first day of the year of disposition (as defined in § 1.168(i)–6(b)(5)), and—

(1) The amount of gain or loss for the asset is determined by taking into account the asset’s adjusted depreciable basis at the time of disposition (as defined in § 1.168(i)–6(b)(3)). The adjusted depreciable basis of the asset at the time of disposition equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the relinquished asset. The depreciation allowance for the asset in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in § 1.168(i)–6(b)(2)) in the year of disposition determined under § 1.168(i)–6. The recognition and character of the gain or loss are determined in accordance with paragraph (e)(3)(iii)(A) of this section, notwithstanding that paragraph (e)(3)(iii) of this section is an optional rule; and

(2) The adjusted depreciable basis of the general asset account at the time of disposition is treated as the adjusted depreciable basis of the relinquished MACRS property.

(B) Like-kind exchange or involuntary conversion of less than all assets remaining in a general asset account. If an asset in a general asset account is transferred by a taxpayer in a like-kind exchange or in an involuntary conversion and if paragraph (e)(3)(v)(A) of this section does not apply to this asset, the taxpayer must apply this paragraph (e)(3)(v)(B) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(v)(B), general asset account treatment for the asset terminates as of the first day of the year of disposition (as defined in § 1.168(i)–6(b)(5)), and—

(1) The amount of gain or loss for the asset is determined by taking into account the asset’s adjusted depreciable basis at the time of disposition (as defined in § 1.168(i)–6(b)(3)). The adjusted depreciable basis of the asset at the time of disposition equals the unadjusted depreciable basis of the asset less the depreciation allowed or allowable for the asset, computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the asset was included and by including the portion of the additional first year depreciation deduction claimed for the general asset account that is attributable to the relinquished asset. The depreciation allowance for the asset in the year of disposition is determined in the same manner as the depreciation allowance for the relinquished MACRS property (as defined in § 1.168(i)–6(b)(2)) in the year of disposition determined under § 1.168(i)–6. The recognition and character of the gain or loss are determined in accordance with paragraph (e)(3)(iii)(A) of this section, notwithstanding that paragraph (e)(3)(iii) of this section is an optional rule; and

(2) As of the first day of the year of disposition, the taxpayer must remove the relinquished asset from the general asset account and make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(vi) Technical termination of a partnership. In the case of a technical termination of a partnership under section 708(b)(1)(B), the terminated partnership must apply this paragraph (e)(3)(vi) instead of applying paragraph (e)(2), (e)(3)(ii), or (e)(3)(iii) of this section. Under this paragraph (e)(3)(vi), all of the terminated partnership’s general asset accounts terminate as of the date of its termination under section 708(b)(1)(B). The terminated partnership computes the allowable depreciation deduction for each of its general asset accounts for the taxable year in which the technical termination occurs by using the depreciation method, recovery period, and convention applicable to the general asset account. The new partnership is not bound by the terminated partnership’s election under paragraph (l) of this section.

(vii) Anti-abuse rule—(A) In general. If an asset in a general asset account is disposed of by a taxpayer in a transaction described in paragraph (e)(3)(vii)(B) of this section, general asset account treatment for the asset terminates as of the first day of the taxable year in which the disposition occurs. Consequently, the taxpayer must determine the amount of gain, loss, or other deduction attributable to the disposition in the manner described in paragraph (e)(3)(iii)(A) of this section, notwithstanding that paragraph (e)(3)(iii)(A) of this section is an optional rule, and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(1) through (4) of this section.

(B) Abusive transactions. A transaction is described in this paragraph (e)(3)(vii)(B) if the transaction is not described in paragraph (e)(3)(iv), (e)(3)(v), or (e)(3)(vi) of this section, and if the transaction is entered into, or made, with a principal purpose of achieving a tax benefit or result that would not be available absent an election under this section. Examples of these types of transactions include—

(1) A transaction entered into with a principal purpose of shifting income or deductions among taxpayers in a manner that would not be possible absent an election under this section to take advantage of differing effective tax rates among the taxpayers; or

(2) An election made under this section with a principal purpose of disposing of an asset from a general asset account to
utilize an expiring net operating loss or credit if the transaction is not a bona fide disposition. The fact that a taxpayer with a net operating loss carryover or a credit carryover transfers an asset to a related person or transfers an asset pursuant to an arrangement where the asset continues to be used or is available for use by the taxpayer pursuant to a lease or otherwise indicates, absent strong evidence to the contrary, that the transaction is described in this paragraph (e)(3)(vii)(B).

(f) Assets generating foreign source income—(1) In general. This paragraph (f) provides the rules for determining the source of any income, gain, or loss recognized, and the appropriate section 904(d) separate limitation category or categories for any foreign source income, gain, or loss recognized on a disposition (within the meaning of paragraph (e)(1) of this section) of an asset in a general asset account that consists of assets generating both United States and foreign source income. These rules apply only to a disposition to which paragraph (e)(2) (general disposition rules), paragraph (e)(3)(ii) (disposition of all assets remaining in a general asset account), paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(v) (transactions subject to section 1031 or section 1033), or paragraph (e)(3)(vii) (anti-abuse rule) of this section applies. Solely for purposes of applying this paragraph (f), the term asset is:

(i) The asset as determined under paragraph (e)(2)(viii) of this section; or

(ii) The portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section.

(2) Source of ordinary income, gain, or loss—(i) Source determined by allocation and apportionment of depreciation allowed. The amount of any ordinary income, gain, or loss that is recognized on the disposition of an asset in a general asset account must be apportioned between United States and foreign sources based on the allocation and apportionment of the—

(A) Depreciation allowed for the general asset account as of the end of the taxable year in which the disposition occurs if paragraph (e)(2) of this section applies to the disposition;

(B) Depreciation allowed for the general asset account as of the time of disposition if the taxpayer applies paragraph (e)(3)(ii) of this section to the disposition of all assets, the last asset, or the remaining portion of the last asset, in the general asset account, or if all the assets, the last asset, or the remaining portion of the last asset, in the general asset account are disposed of in a transaction described in paragraph (e)(3)(v)(A) of this section; or

(C) Depreciation allowed for the asset disposed of for only the taxable year in which the disposition occurs if the taxpayer applies paragraph (e)(3)(iii) of this section to the disposition of the asset in a qualifying disposition, if the asset is disposed of in a transaction described in paragraph (e)(3)(v)(B) of this section (like-kind exchange or involuntary conversion), or if the asset is disposed of in a transaction described in paragraph (e)(3)(vii) of this section (anti-abuse rule).

(ii) Formula for determining foreign source income, gain, or loss. The amount of ordinary income, gain, or loss recognized on the disposition that shall be treated as foreign source income, gain, or loss must be determined under the formula in this paragraph (f)(2)(ii). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

<table>
<thead>
<tr>
<th>Foreign Source Income, Gain, or Loss from the Disposition of an Asset</th>
<th>Total Ordinary Income, Gain, or Loss from the Disposition of an Asset</th>
<th>Allowed Depreciation Deductions</th>
<th>Allocated and Apportioned to Foreign Source Income/Total Allowed Depreciation Deductions for the General Asset Account or for the Asset Disposed of (as applicable)</th>
</tr>
</thead>
</table>

(3) Section 904(d) separate categories. If the assets in the general asset account generate foreign source income in more than one separate category under section 904(d)(1) or another section of the Code (for example, income treated as foreign source income under section 904(g)(10)), or under a United States income tax treaty that requires the foreign tax credit limi-
tion to be determined separately for specified types of income, the amount of foreign source income, gain, or loss from the disposition of an asset, as determined under the formula in paragraph (f)(2)(ii) of this section, must be allocated and apportioned to the applicable separate category or categories under the formula in this paragraph (f)(3). For purposes of this formula, the allowed depreciation deductions are determined for the applicable time period provided in paragraph (f)(2)(i) of this section. The formula is:

\[
\text{Foreign Source Income, Gain, or Loss from the Disposition of an Asset} = \text{Foreign Source Income, Gain, or Loss from the Disposition of an Asset} \times \text{Depreciation Deductions and Apportioned to a Separate Category Total/Allowed Depreciation Deductions and Apportioned to Foreign Source Income}
\]

(g) Assets subject to recapture. If the basis of an asset in a general asset account is increased as a result of the recapture of any allowable credit or deduction (for example, the basis adjustment for the recapture amount under section 30(e)(5), 50(c)(2), 168(l)(6), 168(n)(4), 179(d)(10), 179A(e)(4), or 1400N(d)(5)), general asset account treatment for the asset terminates as of the first day of the taxable year in which the recapture event occurs. Consequently, the taxpayer must remove the asset from the general asset account as of that day and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(h) Changes in use—(1) Conversion to any personal use. An asset in a general asset account becomes ineligible for general asset account treatment if a taxpayer uses the asset in any personal activity during a taxable year. Upon a conversion to any personal use, the taxpayer must remove the asset from the general asset account as of the first day of the taxable year in which the change in use occurs (the year of change) and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section.

(2) Change in use results in a different recovery period and/or depreciation method—(i) No effect on general asset account election. A change in the use described in § 1.168(i)–4(d) (change in use results in a different recovery period or depreciation method) of an asset in a general asset account shall not cause or permit the revocation of the election made under this section.

(ii) Asset is removed from the general asset account. Upon a change in the use described in § 1.168(i)–4(d), the taxpayer must remove the asset from the general asset account as of the first day of the year of change (as defined in § 1.168(i)–4(a)) and must make the adjustments to the general asset account described in paragraphs (e)(3)(iii)(C)(2) through (4) of this section. If, however, the result of the change in use is described in § 1.168(i)–4(d)(3) (change in use results in a shorter recovery period or a more accelerated depreciation method) and the taxpayer elects to treat the asset as though the change in use had not occurred pursuant to § 1.168(i)–4(d)(3)(ii), no adjustment is made to the general asset account upon the change in use.

(iii) New general asset account is established—(A) Change in use results in a shorter recovery period or a more accelerated depreciation method. If the result of the change in use is described in § 1.168(i)–4(d)(3) (change in use results in a shorter recovery period or a more accelerated depreciation method) and adjustments to the general asset account are made pursuant to paragraph (h)(2)(ii) of this section, the taxpayer must establish a new general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the adjusted depreciable basis of the asset as of the first day of the year of change is included in the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under § 1.168(i)–4(d)(3)(i).

(B) Change in use results in a longer recovery period or a slower depreciation method. If the result of the change in use is described in § 1.168(i)–4(d)(4) (change in use results in a longer recovery period or a slower depreciation method), the taxpayer must establish a separate general asset account for the asset in the year of change in accordance with the rules in paragraph (c) of this section, except that the unadjusted depreciable basis of the asset, and the greater of the depreciation of the asset allowed or allowable in accordance with section 1016(a)(2), as of the first day of the year of change are included in the newly established general asset account. Consequently, this general asset account as of the first day of the year of
change will have a beginning balance for both the unadjusted depreciable basis and the depreciation reserve of the general asset account. For purposes of paragraph (c)(2) of this section, the applicable depreciation method, recovery period, and convention are determined under §1.168(i)—4(d)(4)(ii).

(i) Redetermination of basis. If, after the placed-in-service year, the unadjusted depreciable basis of an asset in a general asset account is redetermined due to a transaction other than that described in paragraph (g) of this section (for example, due to contingent purchase price or discharge of indebtedness), the taxpayer’s election under paragraph (l) of this section for the asset also applies to the increase or decrease in basis resulting from the redetermination. For the taxable year in which the increase or decrease in basis occurs, the taxpayer must establish a new general asset account for the amount of the increase or decrease in basis in accordance with the rules in paragraph (c) of this section. For purposes of paragraph (c)(2) of this section, the applicable recovery period for the increase or decrease in basis is the recovery period of the asset remaining as of the beginning of the taxable year in which the increase or decrease in basis occurs, the applicable depreciation method and applicable convention for the increase or decrease in basis are the same depreciation method and convention applicable to the asset that applies for the taxable year in which the increase or decrease in basis occurs, and the increase or decrease in basis is deemed to be placed in service in the same taxable year as the asset.

(j) Identification of disposed or converted asset—(1) In general. The rules of this paragraph (j) apply when an asset in a general asset account is disposed of or converted in a transaction described in paragraph (e)(3)(iii) (disposition of an asset in a qualifying disposition), paragraph (e)(3)(iv)(B) (transactions subject to section 168(i)(7)), paragraph (e)(3)(v)(B) (transactions subject to section 1031 or section 1033), paragraph (e)(3)(vii) (anti-abuse rule), paragraph (g) (assets subject to recapture), or paragraph (h)(1) (conversion to any personal use) of this section.

(2) Identifying which asset is disposed of or converted—(i) In general. For purposes of identifying which asset in a general asset account is disposed of or converted, a taxpayer must identify the disposed of or converted asset by using—

(A) The specific identification method of accounting. Under this method of accounting, the taxpayer can determine the particular taxable year in which the disposed of or converted asset was placed in service by the taxpayer;

(B) A first-in, first-out method of accounting if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period during the taxable year but the taxpayer cannot readily determine from its records the unadjusted depreciable basis of the disposed of or converted asset. Under this method of accounting, the taxpayer identifies the general asset account with the earliest placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion, and the taxpayer treats the disposed of or converted asset as being from that general asset account. To determine which general asset account has assets at the beginning of the taxable year of the disposition or conversion, the taxpayer reduces the number of assets originally included in the account by the number of assets disposed of or converted in any prior taxable year in a transaction to which this paragraph (j) applies;

(C) A modified first-in, first-out method of accounting if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period during the taxable year and the unadjusted depreciable basis of the disposed of or converted asset. Under this method of accounting, the taxpayer identifies the general asset account with the earliest placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion with the same unadjusted depreciable basis as the disposed of or converted asset, and the taxpayer treats the disposed of or converted asset as being from that general asset account. To determine which general asset account has assets at the beginning of the taxable year of the disposition or conversion, the taxpayer reduces the number of assets originally included in the account by the number of assets disposed of or converted in any prior taxable year in a transaction to which this paragraph (j) applies;

(D) A mortality dispersion table if the asset is a mass asset accounted for in a separate general asset account in accordance with paragraph (c)(2)(ii)(H) of this section and if the taxpayer can readily determine from its records the total dispositions of assets with the same recovery period during the taxable year. The mortality dispersion table must be based upon an acceptable sampling of the taxpayer’s actual disposition and conversion experience for mass assets or other acceptable statistical or engineering techniques. To use a mortality dispersion table, the taxpayer must adopt recordkeeping practices consistent with the taxpayer’s prior practices and consonant with good accounting and engineering practices; or

(E) Any other method as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin (see §601.601(d)(2) of this chapter) on or after September 19, 2013. See paragraph (j)(2)(iii) of this section regarding the last-in, first-out method of accounting.

(ii) Disposition of a portion of an asset. If a taxpayer disposes of a portion of an asset and paragraph (e)(1)(ii) of this section applies to that disposition, the taxpayer may identify the asset by using any applicable method provided in paragraph (j)(2) of this section, after taking into account paragraph (j)(2)(iii) of this section.

(iii) Last-in, first-out method of accounting. For purposes of paragraph (j)(2) of this section, a last-in, first-out method of accounting may not be used. Examples of a last-in, first-out method of accounting include the taxpayer identifying the general asset account with the most recent placed-in-service year that has the same recovery period as the disposed of or converted asset and that has assets at the beginning of the taxable year of the disposition or conversion, and the taxpayer treating the disposed of or converted asset as being from that general asset account, or the taxpayer treating the disposed portion of an asset as being from the general asset account with the most recent placed-
(3) Basis of disposed of or converted asset. (i) Solely for purposes of this paragraph (j)(3), the term asset is the asset as determined under paragraph (e)(2)(viii) of this section or the portion of such asset that is disposed of in a disposition described in paragraph (e)(1)(ii) of this section. After identifying which asset in a general asset account is disposed of or converted, the taxpayer must determine the unadjusted depreciable basis of, and the depreciation allowed or allowable for, the disposed of or converted asset. If it is impracticable from the taxpayer’s records to determine the unadjusted depreciable basis of the disposed of or converted asset, the taxpayer may use any reasonable method that is consistently applied to all assets in the same general asset account for purposes of determining the unadjusted depreciable basis of the disposed of or converted asset in that general asset account. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement asset is a restoration (as defined in § 1.263(a)–3(k)), and is not a betterment (as defined in § 1.263(a)–3(j)) or an adaptation to a new or different use (as defined in § 1.263(a)–3(l)), discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its successor, the Producer Price Index for Final Demand, or Finished Goods or its successor, the Producer Price Index for Final Demand, or

(B) A pro rata allocation of the unadjusted depreciable basis of the general asset account based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the general asset account; and

(C) A study allocating the cost of the asset to its individual components.

(ii) The depreciation allowed or allowable for the disposed of or converted asset is computed by using the depreciation method, recovery period, and convention applicable to the general asset account in which the disposed of or converted asset was included and by including the additional first year depreciation deduction claimed for the disposed of or converted asset.

(k) Effect of adjustments on prior dispositions. The adjustments to a general asset account under paragraph (e)(3)(iii), (e)(3)(iv), (e)(3)(v), (e)(3)(vi), (g), or (h) of this section have no effect on the recognition and character of prior dispositions subject to paragraph (e)(2) of this section.

(l) Election—(1) Irrevocable election. If a taxpayer makes an election under this paragraph (l), the taxpayer consents to, and agrees to apply, all of the provisions of this section to the assets included in a general asset account. Except as provided in paragraph (c)(1)(ii)(A), (e)(3), (g), or (h) of this section or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), an election made under this section is irrevocable and will be binding on the taxpayer for computing taxable income for the taxable year for which the election is made and for all subsequent taxable years. An election under this paragraph (l) is made separately by each person owning an asset to which this section applies (for example, by each member of a consolidated group, at the partnership level and not by the partner separately, or at the S corporation level and not by the shareholder separately).

   **Effective/applicability dates—(1)**

   (m) In general. This section applies to taxable years beginning on or after January 1, 2014. Except as provided in paragraphs (m)(2), (m)(3), and (m)(4) of this section, § 1.168(i)–1 as contained in 26 CFR part 1 edition revised as of April 1, 2011, applies to taxable years beginning before January 1, 2014.

   (2) Early application of this section. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.

   (3) Early application of regulation project REG–110732–13. A taxpayer may rely on the provisions of this section in regulation project REG–110732–13 (2013–43 IRB 404) (see § 601.601(d)(2) of this chapter) for taxable years beginning on or after January 1, 2012. However, a taxpayer may not rely on the provisions of this section in regulation project REG–110732–13 for taxable years beginning on or after January 1, 2014.

   (4) Optional application of TD 9564. A taxpayer may choose to apply § 1.168(i)–1T as contained in 26 CFR part 1 edition revised as of April 1, 2014, to taxable years beginning on or after January 1, 2012. However, a taxpayer may not apply § 1.168(i)–1T as contained in 26 CFR part 1 edition revised as of April 1, 2014, to taxable years beginning on or after January 1, 2014.

   (5) Change in method of accounting. A change to comply with this section for depreciable assets placed in service in a taxable year ending on or after December 30, 2003, is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer also may treat a change to comply with this section for depreciable assets placed in service in a taxable year ending before December 30, 2003, as a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer paragraph (m)(5) does not apply to a change to comply with paragraph (e)(3)(ii), (e)(3)(iii), or (l) of this section, except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

§ 1.168(i)–1T [Removed]

Par. 6. Section 1.168(i)–1T is removed. Par. 7. Section 1.168(i)–7 is amended by revising the last sentence in paragraph (a) and revising paragraphs (b), (c)(2)(ii)(H), and (e) to read as follows:

§ 1.168(i)–7 Accounting for MACRS property.

(a) ** For rules applicable to general asset accounts, see § 1.168(i)–1.

(b) ** Required use of single asset accounts. A taxpayer must account for an asset in a single asset account if the taxpayer uses the asset both in a trade or business or for the production of income and in a personal activity, or if the taxpayer places in service and disposes of the asset during the same taxable year. Also, if general asset account treatment for an asset terminates under § 1.168(i)–1(c)(1)(ii)(A), (e)(3)(iii),

September 2, 2014
(e)(3)(v), (e)(3)(vii), (g), or (h)(1), as applicable, the taxpayer must account for the asset in a single asset account beginning in the taxable year in which the general asset account treatment for the asset terminates. If a taxpayer accounts for an asset in a multiple asset account or a pool and the taxpayer disposes of the asset, the taxpayer must account for the asset in a single asset account beginning in the taxable year in which the disposition occurs. See §1.168(i)–8(h)(2)(i). If a taxpayer disposes of a portion of an asset and §1.168(i)–8(d)(1) applies to that disposition, the taxpayer must account for the disposed portion in a single asset account beginning in the taxable year in which the disposition occurs. See §1.168(i)–8(h)(3)(i).

(c) * * *

(2) * * *

(ii) * * *

(H) Mass assets (as defined in §1.168(i)–8(b)(3)) that are or will be subject to §1.168(i)–8(g)(2)(iii) (disposed of or converted mass asset is identified by a mortality dispersion table) must be grouped into a separate multiple asset account or pool.

* * * *

(e) Effective/applicability dates—(1) In general. This section applies to taxable years beginning on or after January 1, 2014.

(2) Early application of this section. A taxpayer may choose to apply the provisions of this section to taxable years beginning on or after January 1, 2012.

(3) Early application of regulation project REG–110732–13. A taxpayer may rely on the provisions of this section in regulation project REG–110732–13 (2013–43 IRB 404) (see §601.601(d)(2) of this chapter) for taxable years beginning on or after January 1, 2012. However, a taxpayer may not rely on the provisions of this section in regulation project REG–110732–13 for taxable years beginning on or after January 1, 2014.

(4) Optional application of TD 9564. A taxpayer may choose to apply §1.168(i)–7T as contained in 26 CFR part 1 edition revised as of April 1, 2013, to taxable years beginning on or after January 1, 2014.

(5) Change in method of accounting. A change to comply with this section for depreciable assets placed in service in a taxable year ending on or after December 30, 2003, is a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply. A taxpayer also may treat a change to comply with this section for depreciable assets placed in service in a taxable year ending before December 30, 2003, as a change in method of accounting to which the provisions of section 446(e) and the regulations under section 446(e) apply.

Par. 8. Section 1.168(i)–8 is added to read as follows:

§1.168(i)–8 Dispositions of MACRS property.

(a) Scope. This section provides rules applicable to dispositions of MACRS property (as defined in §1.168(b)–1(a)(2)) or to depreciable property (as defined in §1.168(b)–1(a)(1)) that would be MACRS property but for an election made by the taxpayer either to expense all or some of the property’s cost under section 179, section 179A, section 179B, section 179C, section 179D, or section 1400I(a)(1), or any similar provision, or to amortize all or some of the property’s cost under section 1400I(a)(2) or any similar provision. This section also applies to dispositions described in paragraph (d)(1) of this section of a portion of such property. Except as provided in §1.168(i)–1(e)(3), this section does not apply to dispositions of assets included in a general asset account. For rules applicable to dispositions of assets included in a general asset account, see §1.168(j)–1(e).

(b) Definitions. For purposes of this section—

(1) Building has the same meaning as that term is defined in §1.48–1(e)(1).

(2) Disposition occurs when ownership of the asset is transferred or when the asset is permanently withdrawn from use either in the taxpayer’s trade or business or in the production of income. A disposition includes the sale, exchange, retirement, physical abandonment, or destruction of an asset. A disposition also occurs when an asset is transferred to a supplies, scrap, or similar account, or when a portion of an asset is disposed of as described in paragraph (d)(1) of this section. If a structural component, or a portion thereof, of a building is disposed of in a disposition described in paragraph (d)(1) of this section, a disposition also includes the disposition of such structural component or such portion thereof.

(3) Mass assets is a mass or group of individual items of depreciable assets—

(i) That are not necessarily homogeneous;

(ii) Each of which is minor in value relative to the total value of the mass or group;

(iii) Numerous in quantity;

(iv) Usually accounted for only on a total dollar or quantity basis;

(v) With respect to which separate identification is impracticable; and

(vi) Placed in service in the same taxable year.

(4) Portion of an asset is any part of an asset that is less than the entire asset as determined under paragraph (c)(4) of this section.

(5) Structural component has the same meaning as that term is defined in §1.48–1(e)(2).

(6) Unadjusted depreciable basis of the multiple asset account or pool is the sum of the unadjusted depreciable bases (as defined in §1.168(b)–1(a)(3)) of all assets included in the multiple asset account or pool.

(c) Special rules—(1) Manner of disposition. The manner of disposition (for example, normal retirement, abnormal retirement, ordinary retirement, or extraordinary retirement) is not taken into account in determining whether a disposition occurs or gain or loss is recognized.

(2) Disposition by transfer to a supplies account. If a taxpayer made an election under §1.162–3(d) to treat the cost of any rotatable spare part, temporary spare part, or standby emergency spare part (as defined in §1.162–3(c)) as a capital expenditure subject to the allowance for depreciation, the taxpayer can dispose of the rotatable, temporary, or standby emergency spare part by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the §1.162–3(d) election. If a tax-
payers made an election under § 1.162–3T(d) to treat the cost of any material and supply (as defined in § 1.162–3T(c)(1)) as a capital expenditure subject to the allowance for depreciation, the taxpayer can dispose of the material and supply by transferring it to a supplies account only if the taxpayer has obtained the consent of the Commissioner to revoke the § 1.162–3T(d) election. See § 1.162–3(d)(3) for the procedures for revoking a § 1.162–3(d) or a § 1.162–3T(d) election.

(3) Leasehold improvements. This section also applies to—

(i) A lessor of leased property that made an improvement to that property for the lessee of the property, has a depreciable basis in the improvement, and disposes of the improvement, or disposes of a portion of the improvement under paragraph (d)(1) of this section, before or upon the termination of the lease with the lessee. See section 168(i)(8)(B); and

(ii) A lessee of leased property that made an improvement to that property, has a depreciable basis in the improvement, and disposes of the improvement, or disposes of a portion of the improvement under paragraph (d)(1) of this section, before or upon the termination of the lease.

(4) Determination of asset disposed of—(i) General rules. For purposes of applying this section, the facts and circumstances of each disposition are considered in determining what is the appropriate asset disposed of. The asset for disposition purposes may not consist of items placed in service by the taxpayer on different dates, without taking into account the applicable convention. For purposes of determining what is the appropriate asset disposed of, the unit of property determined under § 1.263(a)–3(e) or in published guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) under section 263(a) does not apply.

(ii) Special rules. In addition to the general rules in paragraph (c)(4)(i) of this section, the following rules apply for purposes of applying this section:

(A) Each building, including its structural components, is the asset, except as provided in § 1.1250–1(a)(2)(ii) or in paragraph (c)(4)(ii)(B) or (D) of this section.

(B) If a building has two or more condominium or cooperative units, each condominium or cooperative unit, including its structural components, is the asset, except as provided in § 1.1250–1(a)(2)(ii) or in paragraph (c)(4)(ii)(D) of this section.

(C) If a taxpayer properly includes an item in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56 (1987–2 CB 674) (see § 601.601(d)(2) of this chapter) or properly classifies an item in one of the categories under section 168(e)(3), except for a category that includes buildings or structural components (for example, retail motor fuels outlet, qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property), each item is the asset provided paragraph (c)(4)(ii)(D) of this section does not apply to the item. For example, each desk is the asset, each computer is the asset, and each qualified smart electric meter is the asset.

(D) If the taxpayer places in service an improvement or addition to an asset after the taxpayer placed the asset in service, the improvement or addition and, if applicable, its structural components are a separate asset.

(d) Disposition of a portion of an asset—(1) In general. For purposes of applying this section, a disposition includes a disposition of a portion of an asset as a result of a casualty event described in section 165, a disposition of a portion of an asset for which gain, determined without regard to section 1245 or section 1250, is not recognized in whole or in part under section 1031 or section 1033, a transfer of a portion of an asset in a transaction described in section 168(i)(7)(B), or a sale of a portion of an asset, even if the taxpayer does not make the election under paragraph (d)(2)(i) of this section for that disposed portion. For other transactions, a disposition includes a disposition of a portion of an asset only if the taxpayer makes the election under paragraph (d)(2)(i) of this section for that disposed portion.

(2) Partial disposition election—(i) In general. A taxpayer may make an election under this paragraph (d)(2) to apply this section to a disposition of a portion of an asset. If the asset is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56, a taxpayer may make an election under this paragraph (d)(2) to apply this section to a disposition of a portion of such asset only if the taxpayer classifies the replacement portion of the asset under the same asset class as the disposed portion of the asset.

(ii) Time and manner for making election—(A) Time for making election. Except as provided in paragraph (d)(2)(iii) or (iv) of this section, a taxpayer must make the election specified in paragraph (d)(2)(i) of this section by the due date, including extensions, of the original Federal tax return for the taxable year in which the portion of an asset is disposed of by the taxpayer.

(B) Manner of making election. Except as provided in paragraph (d)(2)(iii) or (iv) of this section, a taxpayer may make the election specified in paragraph (d)(2)(i) of this section by applying the provisions of this section for the taxable year in which the portion of an asset is disposed of by the taxpayer, by reporting the gain, loss, or other deduction on the taxpayer’s timely filed, including extensions, original Federal tax return for that taxable year, and, if the asset is properly included in one of the asset classes 00.11 through 00.4 of Rev. Proc. 87–56, by classifying the replacement portion of such asset under the same asset class as the disposed portion of the asset in the taxable year in which the replacement portion is placed in service by the taxpayer. Except as provided in paragraph (d)(2)(iii) or (iv)(B) of this section or except as otherwise expressly provided by other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter), the election specified in paragraph (d)(2)(i) of this section may not be made through the filing of an application for change in accounting method.

(iii) Special rule for subsequent Internal Revenue Service adjustment. This paragraph (d)(2)(iii) applies when a taxpayer deducted the amount paid or incurred for the replacement of a portion of an asset as a repair under § 1.162–4, the taxpayer did not make the election specified in paragraph (d)(2)(i) of this section for the disposed portion of that asset within the time and in the manner under paragraph (d)(2)(ii) or (iv) of this section, and as a result of an examination of the taxpayer’s Federal tax return, the Internal Revenue Service disallows the taxpayer’s repair deduction for the amount paid or incurred for the replacement of the portion
of that asset and instead capitalizes such amount under § 1.263(a)–2 or § 1.263(a)–3. If this paragraph (d)(2)(iii) applies, the taxpayer may make the election specified in paragraph (d)(2)(i) of this section for the disposition of the portion of the asset to which the Internal Revenue Service’s adjustment pertains by filing an application for change in accounting method, provided the asset of which the disposed portion was a part is owned by the taxpayer at the beginning of the year of change (as defined for purposes of section 446(e)).

(iv) Special rules for 2012 or 2013 returns. If, under paragraph (j)(2) of this section, a taxpayer chooses to apply the provisions of this section to a taxable year beginning on or after January 1, 2012, and ending on or before September 19, 2013 (applicable taxable year), and the taxpayer did not make the election specified in paragraph (d)(2)(i) of this section on its timely filed original Federal tax return for the applicable taxable year, including extensions, the taxpayer must make the election specified in paragraph (d)(2)(i) of this section for the applicable taxable year by filing either—

(A) An amended Federal tax return for the applicable taxable year on or before 180 days from the due date including extensions of the taxpayer’s Federal tax return for the first or second taxable year succeeding the applicable taxable year.

(v) Revocation. A taxpayer may revoke the election specified in paragraph (d)(2)(i) of this section only by filing a request for a private letter ruling and obtaining the Commissioner’s consent to revoke the election. The Commissioner may grant a request to revoke this election if the taxpayer acted reasonably and in good faith, and the revocation will not prejudice the interests of the Government. See generally § 301.9100–3 of this chapter. The election specified in paragraph (d)(2)(i) of this section may not be revoked through the filing of an application for change in accounting method.

(e) Gain or loss on dispositions. Solely for purposes of this paragraph (e), the term asset is an asset within the scope of this section or the portion of such asset that is disposed of in a disposition described in paragraph (d)(1) of this section. Except as provided by section 280B and § 1.280B–1, the following rules apply when an asset is disposed of during a taxable year:

(1) If an asset is disposed of by sale, exchange, or involuntary conversion, gain or loss must be recognized under the applicable provisions of the Internal Revenue Code.

(2) If an asset is disposed of by physical abandonment, loss must be recognized in the amount of the adjusted depreciable basis (as defined in § 1.168(b)–1(a)(4)) of the asset at the time of the abandonment, taking into account the applicable convention. However, if the abandoned asset is subject to nonrecourse indebtedness, paragraph (e)(1) of this section applies to the asset instead of this paragraph (e)(2). For a loss from physical abandonment to qualify for recognition under this paragraph (e)(2), the taxpayer must intend to discard the asset irrevocably so that the taxpayer will neither use the asset again nor retrieve it for sale, exchange, or other disposition.

(3) If an asset is disposed of other than by sale, exchange, involuntary conversion, physical abandonment, or conversion to personal use (as, for example, when the asset is transferred to a supplies or scrap account), gain is not recognized. Loss must be recognized in the amount of the excess of the adjusted depreciable basis of the asset at the time of the disposition, taking into account the applicable convention, over the asset’s fair market value at the time of the disposition, taking into account the applicable convention.

(f) Basis of asset disposed of—(1) In general. The adjusted basis of an asset disposed of for computing gain or loss is its adjusted depreciable basis at the time of the asset’s disposition, as determined under the applicable convention for the asset.

(2) Assets disposed of are in multiple asset accounts. (i) If the taxpayer accounts for the asset disposed of in a multiple asset account or pool and it is impracticable from the taxpayer’s records to determine the unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the asset disposed of, the taxpayer may use any reasonable method that is consistently applied to all assets in the same multiple asset account or pool for purposes of determining the unadjusted depreciable basis of assets disposed of. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement asset is a restoration (as defined in § 1.263(a)–3(k)), and is not a betterment (as defined in § 1.263(a)–3(j)) or an adaptation to a new or different use (as defined in § 1.263(a)–3(l)), discounting the cost of the replacement asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) for purposes of this paragraph (f)(2);

(B) A pro rata allocation of the unadjusted depreciable basis of the multiple asset account or pool based on the replacement cost of the disposed asset and the replacement cost of all of the assets in the multiple asset account or pool; and

(C) A study allocating the cost of the asset to its individual components.

(ii) To determine the adjusted depreciable basis of an asset disposed of in a multiple asset account or pool, the depreciation allowed or allowable for the asset disposed of is computed by using the depreciation method, recovery period, and convention applicable to the multiple asset account or pool in which the asset disposed of was included and by including the additional first year depreciation deduction claimed for the asset disposed of.

(3) Disposition of a portion of an asset. (i) This paragraph (f)(3) applies only when a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition. For computing gain or loss, the adjusted basis of the disposed portion of the asset is the adjusted depreciable basis of that disposed portion at the time of its disposition, as determined under the applicable convention for the asset.

(ii) The unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the disposed portion of the asset is determined by applying the qualified asset pool (QAP) or multiple asset pool (MAP) method described in paragraphs (f)(3)(i) and (ii) to the disposed portion of the asset and the unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the entire asset. The adjusted basis of the disposed portion of the asset is determined by applying the qualified asset pool (QAP) or multiple asset pool (MAP) method described in paragraphs (f)(3)(i) and (ii) to the disposed portion of the asset and the adjusted basis (as defined in § 1.168(b)–1(a)(4)) of the entire asset.
posed portion of the asset, the taxpayer may use any reasonable method for purposes of determining the unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the disposed portion of the asset. If a taxpayer disposes of more than one portion of the same asset and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the first disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all portions of the same asset for purposes of determining the unadjusted depreciable basis of each disposed portion of the asset. If the asset, a portion of which is disposed of, is in a multiple asset account or pool and it is impracticable from the taxpayer's records to determine the unadjusted depreciable basis (as defined in § 1.168(b)–1(a)(3)) of the disposed portion of the asset, the reasonable method used by the taxpayer must be consistently applied to all assets in the same multiple asset account or pool for purposes of determining the unadjusted depreciable basis of assets disposed of or any disposed portion of the assets. Examples of a reasonable method include, but are not limited to, the following:

(A) If the replacement portion is a restoration (as defined in § 1.263(a)–3(k)), and is not a betterment (as defined in § 1.263(a)–3(j)) or an adaptation to a new or different use (as defined in § 1.263(a)–3(l)), discounting the cost of the replacement portion of the asset to its placed-in-service year cost using the Producer Price Index for Finished Goods or its successor, the Producer Price Index for Final Demand, or any other index designated by guidance in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) for purposes of this paragraph (f)(3);

(B) A pro rata allocation of the unadjusted depreciable basis of the asset based on the replacement cost of the disposed portion of the asset and the replacement cost of the asset; and

(C) A study allocating the cost of the asset to its individual components.

(ii) To determine the adjusted depreciable basis of the disposed portion of the asset, the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion.

(g) Identification of asset disposed of—

(1) In general. Except as provided in paragraph (g)(2) or (3) of this section, a taxpayer must use the specific identification method of accounting to identify which asset is disposed of by the taxpayer. Under this method of accounting, the taxpayer can determine the particular taxable year in which the asset disposed of was placed in service by the taxpayer.

(2) Asset disposed of is in a multiple asset account. If a taxpayer accounts for the asset disposed of in a multiple asset account or pool and the total dispositions of assets with the same recovery period during the taxable year are readily determined from the taxpayer's records, but it is impracticable from the taxpayer's records to determine the particular taxable year in which the asset disposed of was placed in service by the taxpayer, the taxpayer must identify the asset disposed of by using—

(i) A first-in, first-out method of accounting if the unadjusted depreciable basis of the asset disposed of cannot be readily determined from the taxpayer's records. Under this method of accounting, the taxpayer identifies the multiple asset account or pool with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition, and the taxpayer treats the asset disposed of as being from that multiple asset account or pool;

(ii) A modified first-in, first-out method of accounting if the unadjusted depreciable basis of the asset disposed of can be readily determined from the taxpayer's records. Under this method of accounting, the taxpayer identifies the multiple asset account or pool with the earliest placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition, and the taxpayer treats the asset disposed of as being from that multiple asset account or pool;

(iii) A mortality dispersion table if the asset disposed of is a mass asset. The mortality dispersion table must be based upon an acceptable sampling of the taxpayer's actual disposition experience for mass assets or other acceptable statistical or engineering techniques. To use a mortality dispersion table, the taxpayer must adopt recordkeeping practices consistent with the taxpayer's prior practices and consonant with good accounting and engineering practices; or

(iv) Any other method as the Secretary may designate by publication in the Federal Register or in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter) on or after September 19, 2013. See paragraph (g)(4) of this section regarding the last-in, first-out method of accounting.

(3) Disposition of a portion of an asset. If a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition, but it is impracticable from the taxpayer's records to determine the particular taxable year in which the asset was placed in service, the taxpayer must identify the asset by using any applicable method provided in paragraph (g)(2) of this section, after taking into account paragraph (g)(4) of this section.

(4) Last-in, first-out method of accounting. For purposes of this paragraph (g), a last-in, first-out method of accounting may not be used. Examples of a last-in, first-out method of accounting include the taxpayer identifying the multiple asset account or pool with the most recent placed-in-service year that has the same recovery period as the asset disposed of and that has assets at the beginning of the taxable year of the disposition, and the taxpayer treating the asset disposed of as being from that multiple asset account or pool; or the taxpayer treating the disposed portion of an asset as being from an asset with the most recent placed-in-service year that is the same as the asset of which the disposed portion is a part.

(b) Accounting for asset disposed of—

(1) Depreciation ends. Depreciation ends for an asset at the time of the asset's disposition, as determined under the applicable convention for the asset. See § 1.167(a)–10(b). If the asset disposed of is in a single asset account initially or as a result of § 1.168(i)–8(h)(2)(i), § 1.168(i)–
8(h)(3)(i), or general asset account treatment for the asset terminated under § 1.168(i)–1(c)(1)(ii)(A), (e)(3)(iii), (e)(3)(v), (e)(3)(vii), (g), or (h)(1), as applicable, the single asset account terminates at the time of the asset’s disposition, as determined under the applicable convention for the asset. If a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition, depreciation ends for that disposed portion of the asset at the time of the disposition of the disposed portion, as determined under the applicable convention for the asset.

(2) Asset disposed of in a multiple asset account or pool. If the taxpayer accounts for the asset disposed of in a multiple asset account or pool, then—

(i) As of the first day of the taxable year in which the disposition occurs, the asset disposed of is removed from the multiple asset account or pool and is placed into a single asset account. See § 1.168(i)–7(b);

(ii) The unadjusted depreciable basis of the multiple asset account or pool must be reduced by the unadjusted depreciable basis of the asset disposed of as of the first day of the taxable year in which the disposition occurs. See paragraph (f)(2)(i) of this section for determining the unadjusted depreciable basis of the asset disposed of;

(iii) The depreciation reserve of the multiple asset account or pool must be reduced by the depreciation allowed or allowable for the disposed portion as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion;

(iv) In determining the adjusted depreciable basis of the disposed portion at the time of disposition, taking into account the applicable convention, the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the multiple asset account or pool in which the asset disposed of was included and by including the additional first year depreciation deduction claimed for the asset disposed of.

(3) Disposition of a portion of an asset. This paragraph (h)(3) applies only when a taxpayer disposes of a portion of an asset and paragraph (d)(1) of this section applies to that disposition. In this case—

(i) As of the first day of the taxable year in which the disposition occurs, the disposed portion is placed into a single asset account. See § 1.168(i)–7(b);

(ii) The unadjusted depreciable basis of the asset must be reduced by the unadjusted depreciable basis of the disposed portion as of the first day of the taxable year in which the disposition occurs. See paragraph (f)(3)(i) of this section for determining the unadjusted depreciable basis of the disposed portion;

(iii) The depreciation reserve of the asset must be reduced by the depreciation allowed or allowable for the disposed portion as of the end of the taxable year immediately preceding the year of disposition, computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion;

(iv) In determining the adjusted depreciable basis of the disposed portion at the time of disposition, taking into account the applicable convention, the depreciation allowed or allowable for the disposed portion is computed by using the depreciation method, recovery period, and convention applicable to the asset in which the disposed portion was included and by including the portion of the additional first year depreciation deduction claimed for the asset that is attributable to the disposed portion.

(i) Examples. The application of this section is illustrated by the following examples:

Example 1. A owns an office building with four elevators. A replaces one of the elevators. The elevator is a structural component of the office building. In accordance with paragraph (c)(4)(ii)(A) of this section, the office building, including its structural components, is the asset for disposition purposes. A does not make the partial disposition election provided under paragraph (d)(2) of this section for the elevator. Thus, the retirement of the replaced elevator is not a disposition. As a result, depreciation continues for the cost of the building, including the cost of the retired elevator and the building’s other structural components, and A does not recognize a loss for this retired elevator. If A must capitalize the amount paid for the replacement elevator pursuant to § 1.263(a)–3, the replacement elevator is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 2. The facts are the same as in Example 1, except A accounts for each structural component of the office building as a separate asset in its fixed asset system. Although A treats each structural component as a separate asset in its records, the office building, including its structural components, is the asset for disposition purposes in accordance with paragraph (c)(4)(ii)(A) of this section. Accordingly, the result is the same as in Example 1.

Example 3. The facts are the same as in Example 1, except A makes the partial disposition election provided under paragraph (d)(2) of this section for the elevator. Although the office building, including its structural components, is the asset for disposition purposes, the result of A making the partial disposition election for the elevator is that the retirement of the replaced elevator is a disposition. Thus, depreciation for the retired elevator ceases at the time of its retirement, taking into account the applicable convention, and A recognizes a loss upon this retirement. Further, A must capitalize the amount paid for the replacement elevator pursuant to § 1.263(a)–3(k)(1)(i), and the replacement elevator is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 4. B, a calendar-year commercial airline company, owns several aircraft that are used in the commercial carrying of passengers and described in asset class 45.0 of Rev. Proc. 87–56. B replaces the existing engines on one of the aircraft with new engines. Assume each aircraft is a unit of property as determined under § 1.263(a)–3(e)(3) and each engine of an aircraft is a major component or substantial structural part of the aircraft as determined under § 1.263(a)–3(k)(6). Assume also that B treats each aircraft as the asset for disposition purposes in accordance with paragraph (c)(4) of this section. B makes the partial disposition election provided under paragraph (d)(2) of this section for the engines in the aircraft. Although the aircraft is the asset for disposition purposes, the result of B making the partial disposition election for the engines is that the retirement of the replaced engines is a disposition. Thus, depreciation for the retired engines ceases at the time of their retirement, taking into account the applicable convention, and B recognizes a loss upon this retirement. Further, B must capitalize the amount paid for the replacement engines pursuant to § 1.263(a)–3(k)(1)(i), and the replacement engines are a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).
Example 5. The facts are the same as in Example 4, except B does not make the partial disposition election provided under paragraph (d)(2) of this section for the engines. Thus, the retirement of the replaced engines on one of the aircraft is not a disposition. As a result, depreciation continues for the cost of the aircraft, including the cost of the replacement 55% of the roof, and B does not recognize a loss for these retired engines. If B must capitalize the amount paid for the replacement engines pursuant to § 1.263(a)–3, the replacement engines are a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 6. C, a corporation, owns several trucks that are used in its trade or business and described in asset class 00.241 of Rev. Proc. 87–56. C replaces the engine on one of the trucks with a new engine. Assume each truck is a unit of property as determined under § 1.263(a)–3(3)(ii)(A) and each engine is a major component or substantial structural part of the truck as determined under § 1.263(a)–3(3)(ii)(6). Because the trucks are described in asset class 00.241 of Rev. Proc. 87–56, C must treat each truck as the asset for disposition purposes. C does not make the partial disposition election provided under paragraph (d)(2) of this section for the engine. Thus, the retirement of the replaced engine on the truck is not a disposition. As a result, depreciation continues for the cost of the truck, including the cost of the retired engine, and C does not recognize a loss for this retired engine. If C must capitalize the amount paid for the replacement engine pursuant to § 1.263(a)–3, the replacement engine is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(A) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 7. D owns a retail building. D replaces 60% of the roof of this building. In accordance with paragraph (c)(4)(ii)(A) of this section, the retail building, including its structural components, is the asset for disposition purposes. Assume D must capitalize the costs incurred for replacing 60% of the roof pursuant to paragraph (d)(2) of this section for the roof. D makes the partial disposition election provided under paragraph (d)(2) of this section for the 60% of the roof. Therefore, the retirement of 25% of the 60% of the roof replaced ten years ago ceases at the time of its retirement, taking into account the applicable convention, and D recognizes a loss upon this retirement. Also, D must capitalize the amount paid for the 55% of the roof pursuant to § 1.263(a)–3(k)(1)(i) and (vi), and the replacement 55% of the roof is a separate asset for disposition purposes pursuant to paragraph (c)(4)(ii)(D) of this section and for depreciation purposes pursuant to section 168(i)(6).

Example 9. (i) On July 1, 2011, E, a calendar-year taxpayer, purchased and placed in service an existing multi-story office building that costs $20,000,000. The cost of each structural component of the building was not separately stated. E accounts for the building and its structural components in its tax and financial accounting records as a single asset with a cost of $20,000,000. E depreciates the building as nonresidential real property and uses the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention. As of January 1, 2014, the depreciation reserve for the building is $1,251,542 ($1,261,000 less the depreciation allowed or allowable of $10,452 removed from the building cost less the depreciation allowed or allowable of $7,763 for 2014). As a result, E recognizes a loss of $138,779 for the retired elevator for the calendar year 2014.

Example 10. (i) Since 2005, F, a calendar year taxpayer, has accounted for items of MACRS property that are mass assets in pools. Each pool includes only the mass assets that have the same identity and characteristics and are placed in service by F in the same taxable year. None of the pools are general asset accounts under section 168(i)(4) and the regulations under section 168(i)(4). F identifies any dispositions of these mass assets by specific identification.

(ii) During 2014, F sells 10 items of mass assets with a 5-year recovery period each for $100. Under the specific identification method, F identifies these mass assets as being from the pool established by F in 2012 for mass assets with a 5-year recovery period. Assume F depreciates this pool using the optional depreciation table that corresponds with the general depreciation system, the straight-line method, a 39-year recovery period, and the mid-month convention. As a result, F recognizes a loss of $100 for the retired elevator for the calendar year 2014.
recovery period, and the half-year convention. F
selected not to deduct the additional first year
depreciation provided by section 168(k) for
5-year property placed in service during 2012. As
of January 1, 2014, this pool contains 100 similar
items of mass assets with a total cost of $25,000
and a total depreciation reserve of $13,000. Be-
cause all the items of mass assets in the pool are
similar, F allocates the cost and depreciation al-
lowed or allowable for the pool ratably among
each item in the pool. This allocation is a rea-
sonable method because all the items of mass assets
in the pool are similar. Using this reasonable
method, F allocates a cost of $250 ($25,000 
(1/100)) to each disposed of mass asset and depre-
ciation allowed or allowable of $130 ($13,000 
(1/100)) to each disposed of mass asset. The
depreciation allowed or allowable in 2014 for each
disposed of mass asset is $24 (($250 × 19.2%) / 2).
As a result, the adjusted depreciable basis of each
disposed of mass asset under section 1011 is $96
($250 – $130 – $24). Thus, F recognizes a gain of
$4 for each disposed of mass asset in 2014, which
is subject to section 1245.

(iii) Further, as of January 1, 2014, the unad-
justed depreciable basis of the 2012 pool of mass
assets with a 5-year recovery period is reduced
from $25,000 to $22,500 ($25,000 less the unad-
justed depreciable basis of $2,500 for the 10
disposed of items), and the depreciation reserve
of this 2012 pool is reduced from $13,000 to $11,700
($13,000 less the depreciation allowed or allow-
able of $1,300 for the 10 disposed of items as of
December 31, 2013). Consequently, as of January
1, 2014, the 2012 pool of mass assets with a 5-year
recovery period has 90 items with a total cost of
$22,500 and a depreciation reserve of $11,700.
Thus, the depreciation allowance for this pool for
2014 is $4,320 ($22,500 × 19.2%).

Example 11. (i) The facts are the same as in
Example 10. Because of changes in F’s record-
keeping in 2015, it is impracticable for F to con-
tinue to identify disposed of mass assets using
specific identification and to determine the unad-
justed depreciable basis of the disposed of mass
assets. As a result, F files a Form 3115, Applica-
tion 446(e) to treat a change to comply with this section or otherwise provided by
other guidance published in the Internal Revenue Bulletin (see § 601.601(d)(2) of this chapter).

§ 1.168(i)–8T [Removed]

Par. 9. Section 1.168(i)–8T is removed.

§ 1.263(a)–3 [Amended]

Par. 10. Section 1.263(a)–3 is amended by:

a. In paragraphs (g)(2)(i), (g)(2)(ii) Example 2, and (g)(2)(ii) Example 4, removing the language “Prop. Reg. § 1.168(i)–8(d) (September 19, 2013)” and adding the language “§ 1.168(i)–8(d)” in its place.

b. In paragraph (g)(2)(i), removing the language “§ 1.168(i)–1T(e)(3)” or Prop. Reg. § 1.168(i)–1(e)(3) (September 19, 2013)” and adding the language “§ 1.168(i)–1(e)(3)” in its place, and removing the language “Prop. Reg. § 1.168(i)–1(e)(2)(ix) (September 19, 2013)” and adding the language “§ 1.168(i)–1(e)(1)(ii)” in its place.

c. In paragraphs (g)(2)(ii) and (g)(2)(ii) Example 1, removing the language “Prop. Reg. § 1.168(i)–1–(e)(1) (September 19, 2013), or Prop. Reg. § 1.168(i)–8 (September 19, 2013)” and adding the language “§ 1.168(i)–1(e) or § 1.168(i)–8” in its place.

d. In paragraph (k)(7) Example 30, removing the language “Prop. Reg. § 1.168(i)–8” and adding the language “§ 1.168(i)–8” in its place, and removing the language “Prop. Reg. § 1.168(i)–8(c)(4)(ii)(A) (September 19, 2013)” and adding the language “§ 1.168(i)–8(c)(4)(ii)(A)” in its place.

e. In paragraph (k)(7) Example 30 and Example 31, removing the language “Prop. Reg. § 1.168(i)–8(d)(2) (September 19, 2013),” and adding the language “§ 1.168(i)–8(d)(2)” in its place.

§ 1.471–8(c)(ii)(D) (September 19, 2013)” and adding the language “§ 1.168(i)–8(c)(4)(ii)(D)” in its place.

Par. 11. Section 1.1016–3 is amended by revising the fourth sentence in paragraph (a)(1)(ii) to read as follows:

§ 1.1016–3 Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 13, 1913.

(a) * * *
(1) * * *
(ii) * * * For rules governing losses on retirement or disposition of depreciable property, including rules for determining basis, see § 1.167(a)–8, 1.168(i)–1(e), or 1.168(i)–8, as applicable. * * *

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: July 11, 2014.

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

Section 471.—General rule for inventories
26 CFR 1.471–8: Inventories of retail merchants

T.D. 9688

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Retail Inventory Method

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the retail inventory method of accounting. The regulations restate and clarify the computation of ending inventory values under the retail inventory method and provide a special rule for certain taxpayers that receive margin protection payments or vendor allowances that are required to reduce only cost of goods sold. The regulations affect taxpayers that are retailers and use a retail inventory method.

DATES: Effective Date: These regulations are effective on August 15, 2014.

Applicability Date: For date of applicability, see § 1.471–8(f).

FOR FURTHER INFORMATION CONTACT: Christopher Call, (202) 317-7007 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations that amend the Income Tax Regulations (26 CFR part 1) relating to the retail inventory method of accounting under § 1.471–8 of the Income Tax Regulations. On October 7, 2011, a notice of proposed rulemaking (REG–125949–10) was published in the Federal Register (76 FR 62327). A public hearing was not requested or held. No comments were received during the comment period. Three comments were received after the end of the comment period and were considered, as discussed later in this preamble. The proposed regulations are adopted as amended by this Treasury decision.

Summary of Comments and Explanation of Revisions

Section 471 of the Internal Revenue Code provides that a taxpayer’s method of accounting for inventories must clearly reflect income. Section 1.471–2(c) provides that the bases of inventory valuation most commonly used and meeting the requirements of section 471 are (1) cost and (2) cost or market, whichever is lower (LCM). Section 1.471–3 provides rules for determining inventories at cost. Section 1.471–4 provides rules for determining inventories at lower of cost or market. Section 1.471–8 of the regulations contains rules specific to retailers, allowing them to approximate cost or LCM of the goods in their ending inventory by using the retail inventory method. Under the retail inventory method, a taxpayer computes the value of ending inventory by multiplying a cost complement by the retail selling prices of the goods on hand at the end of the taxable year. The numerator of the cost complement is the value of beginning inventory plus the cost of purchases during the taxable year, and the denominator is the retail selling prices of beginning inventory plus the initial retail selling prices of purchases. For taxpayers using the retail inventory method to value inventories at cost (retail cost method), the denominator of the cost complement is adjusted for all permanent markups and markdowns. Taxpayers using the retail inventory method to value inventories at LCM (retail LCM method) generally do not make adjustments to the denominator for markdowns.

The proposed regulations provided that a taxpayer using the retail LCM method may not reduce the numerator of the cost complement by the amount of an allowance, discount, or price rebate that is related to or intended to compensate for a permanent reduction in the taxpayer’s retail selling price of inventory, often called a margin protection payment or a markdown allowance. The proposed regulations also provided that a taxpayer using the retail inventory method (whether valuing inventories at LCM or at cost) may not reduce the numerator of the cost complement by the amount of a sales-based vendor allowance.

Commenters suggested that taxpayers using the retail LCM method to value inventories should reduce the numerator of the cost complement for all vendor allowances and discounts, including margin protection payments and sales-based vendor allowances (but should not be required to reduce the denominator by the related price reduction), because all allowances and discounts reduce the cost of inventory and allow retailers to achieve their margin goals. The commenters asserted that if the numerator of the cost complement is not reduced for margin protection payments and sales-based vendor allowances, taxpayers’ income will not be clearly reflected, the economics of the underlying business transaction will be ignored, and small retailers would be adversely affected. The commenters suggested that small retailers have less bar-
The final regulations do not adopt these comments. A margin protection payment, unlike other types of allowances, is inherently related to a markdown that will be reflected in the retail selling prices of the items remaining in ending inventory. When a taxpayer using retail LCM reduces the numerator of the cost complement by the amount of a margin protection payment without reducing the denominator by the amount of the corresponding markdown, ending inventory value does not clearly reflect income, and does not reflect the economics of the underlying transaction. Taxpayers using the retail cost method to value inventories, as opposed to retail LCM, are allowed to reduce the numerator of the cost complement by the amount of a margin protection payment because these taxpayers also reduce the denominator of the cost complement by the amount of a related markdown, maintaining the relationship between cost and retail price.

With regard to sales-based vendor allowances, the final regulations adopt, with a modification, the proposed rule that the numerator of the cost complement is not reduced for sales-based vendor allowances. Proposed regulations under § 1.471–3(e) provided that sales-based vendor allowances (the amount of an allowance, discount, or price rebate that a taxpayer earns by selling specific merchandise) reduce cost of goods sold and do not reduce ending inventory value. Because the retail inventory method produces an ending inventory value and sales-based vendor allowances could not be allocated to ending inventory, the proposed regulations under § 1.471–8 provided that sales-based vendor allowances do not reduce the numerator of the cost complement. The final regulations under § 1.471–3(e) (TD 9652, 79 FR 2094) apply specifically to only one type of sales-based vendor allowance, a sales-based vendor chargeback, and reserve rules for other types of sales-based vendor allowances. To conform to this modification, these final regulations under § 1.471–8 provide that sales-based vendor allowances that are required to reduce only cost of goods sold under § 1.471–3(e) do not reduce the numerator of the cost complement. This rule will apply only to sales-based vendor chargebacks until further guidance is issued under § 1.471–3(e).

Commenters also requested that the final regulations allow retail LCM taxpayers to reduce the numerator of the cost complement by margin protection payments and sales-based vendor allowances because requiring taxpayers to track margin protection payments and sales-based vendor allowances separately from other types of allowances would create burdensome recordkeeping requirements. This comment is not adopted because, as discussed earlier in this preamble, allowing a retail LCM taxpayer to reduce the numerator of the cost complement by the amount of a margin protection payment without reducing the denominator by the amount of the corresponding markdown would not clearly reflect income and would not reflect the economics of the underlying transaction. Nonetheless, as discussed later in this preamble, to ease taxpayers’ compliance burden, the final regulations provide alternative methods and procedures for computing the cost complement for retail LCM taxpayers.

The preamble to the proposed regulations requested comments on an alternative method for retail LCM taxpayers to account for margin protection payments when computing the cost complement. The method described in that preamble would have permitted retail LCM taxpayers to reduce the numerator of the cost complement for all non-sales-based allowances, discounts, or price rebates, including margin protection payments or markdown allowances, and also would have required a reduction of the denominator for the related markdowns. Accordingly, a second alternative provided in the final regulations allows taxpayers that are able to determine the amount of their margin protection payments to reduce the numerator of the cost complement for the margin protection payments and adjust the denominator by the amount that, in conjunction with the reduction of the numerator, maintains what would have been the cost complement percentage before taking into account the margin protection payments and related markdowns. This alternative method assumes that a margin protection payment maintains the taxpayer’s profit margin after a related markdown in retail selling price. Thus, if before taking into account the margin protection payment and the related markdown the cost complement is 50 percent...
be eliminated from the cost complement of a last-in, first-out (LIFO) taxpayer using the retail inventory method. These issues were not addressed in the proposed regulations and therefore are not addressed in the final regulations. However, the final regulations do not reflect a change in established administrative practice regarding whether LIFO taxpayers using the retail inventory method may exclude beginning inventory from the cost complement.

Effective/Applicability Date

These regulations apply to taxable years beginning after December 31, 2014. For taxable years beginning before January 1, 2015, see § 1.471–8 as contained in 26 CFR part 1, revised April 1, 2014.

Special Analyses

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. Section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, 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. No comments were received from the Small Business Administration.

Drafting Information

The principal author of these regulations is Natasha M. Mulleneaux of the 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 * * *

Par. 2. Section 1.471–8 is revised to read as follows:

§ 1.471–8 Inventories of retail merchants.

(a) In general. A taxpayer that is a retail merchant may use the retail inventory method of accounting described in this section. The retail inventory method uses a formula to convert the retail selling price of ending inventory to an approximation of cost (retail cost method) or an approximation of lower of cost or market (retail LCM method). A taxpayer may use the retail inventory method instead of valuing inventory at cost under § 1.471–3 or lower of cost or market under § 1.471–4.

(b) Computation—(1) In general. A taxpayer computes the value of ending inventory under the retail inventory method by multiplying a cost complement by the retail selling prices of the goods on hand at the end of the taxable year.

(2) Cost complement—(i) In general. The cost complement is a ratio computed as follows:

(A) The numerator is the value of beginning inventory plus the cost (as determined under § 1.471–3, except as otherwise provided in this section) of goods purchased during the taxable year.

(B) The denominator is the retail selling prices of beginning inventory plus the retail selling prices of goods purchased during the year (that is, the bona fide retail selling prices of the items at the time acquired), adjusted for all permanent markups and markdowns, including markup and markdown cancellations and corrections. The denominator is not adjusted for temporary markups or markdowns.

(ii) Vendor allowances required to reduce only cost of goods sold. A taxpayer may not reduce the numerator of the cost complement.
complement by the amount of an allowance, discount, or price rebate that is required under § 1.471–3(e) to reduce only cost of goods sold.

(3) Additional rules for cost complement for retail LCM method—(i) In general—(A) Margin protection payments. A taxpayer using the retail LCM method may not reduce the numerator of the cost complement by the amount of an allowance, discount, or price rebate that is related to or intended to compensate for a permanent reduction in the taxpayer’s retail selling price of inventory (a margin protection payment).

(B) Markdowns. A taxpayer using the retail LCM method does not adjust the denominator of the cost complement for markdowns (and markdown cancellations or corrections). Markdowns must be reduced by the markdowns made to cancel or correct them.

(ii) Alternative methods for computing cost complement—(A) In general. In lieu of the method described in paragraph (b)(3)(i) of this section, a taxpayer using the retail LCM method may compute the cost complement using one of the alternative methods described in this paragraph (b)(3)(ii). A taxpayer using an alternative method under this paragraph (b)(3)(ii) must use that method for all cost complements.

(B) Adjust numerator and denominator. A taxpayer using the retail LCM method may reduce the numerator of the cost complement by the amount of all margin protection payments if the taxpayer also reduces the denominator of the cost complement by the amount of the permanent reduction in retail selling price to which the margin protection payments relate (related markdowns).

(C) Deemed adjustment to denominator. A taxpayer using the retail LCM method that is able to determine the amount of all margin protection payments but cannot determine the amount of the related markdowns may reduce the numerator of the cost complement by the amount of all margin protection payments if the taxpayer also reduces the denominator by the amount that, in conjunction with the reduction of the numerator for the margin protection payments, maintains what would have been the cost complement percentage before taking into ac-

count the margin protection payment and the related markdown. A taxpayer that can determine the amount of a related markdown but not the associated margin protection payments may not use this method to compute an adjustment to the numerator.

(iii) Statistical sampling. A taxpayer using the retail LCM method may use statistical sampling in accordance with Rev. Proc. 2011–42 or any successor (see § 601.601(d) of this chapter), in conjunction with any method of computing the cost complement described in this paragraph (b)(3), to determine the amount of margin protection payments and related markdowns. A taxpayer using statistical sampling must use it for all margin protection payments and related markdowns associated with the inventory items valued by a particular cost complement, but is not required to use it for every cost complement.

(4) Ending inventory retail selling prices. A taxpayer must include all permanent markdowns and markdowns but may not include temporary markdowns or markdowns in determining the retail selling prices of goods on hand at the end of the taxable year. A taxpayer may not include a markdown that is not an actual reduction of retail selling price.

(c) Special rules for LIFO taxpayers. A taxpayer using the last-in, first-out (LIFO) inventory method with the retail inventory method uses the retail cost method. See § 1.472–1(k) for additional adjustments for a taxpayer using the LIFO inventory method with the retail cost method.

(d) Scope of retail inventory method. A taxpayer may use the retail inventory method to value ending inventory for a department, a class of goods, or a stockkeeping unit. A taxpayer maintaining more than one department or dealing in classes of goods with different percentages of gross profit must compute cost complements separately for each department or class of goods.

(e) Examples. The following examples illustrate the rules of this section:

Example 1. (i) R, a retail merchant who uses the retail LCM method and uses a calendar taxable year, has no beginning inventory in 2012. R purchases 40 tables during 2012 for $60 each for a total of $2,400. R offers the tables for sale at $100 each for an aggregate retail selling price of $4,000. R does not sell any tables at a price of $100, so R permanently marks down the retail selling price of its tables to $90 each. As a result of the $10 markdown, R’s supplier provides R a $6 per table margin protection payment. R sells 25 tables during 2012 and has 15 tables in ending inventory at the end of 2012.

(ii) Under paragraph (b)(3)(i)(A) of this section, the numerator of the cost complement is the aggregate cost of the tables, $2,400. Under paragraph (b)(3)(i)(A) of this section, R may not reduce the numerator of the cost complement by the amount of the margin protection payment. Under paragraph (b)(2)(ii)(B) of this section, the denominator of the cost complement is the aggregate of the bona fide retail selling prices of all the tables at the time acquired, $4,000. Under paragraph (b)(3)(i)(B) of this section, R does not adjust the denominator of the cost complement for the markdown. Therefore, R’s cost complement is $2,400/$4,000, or 60%.

(iii) Under paragraph (b)(4) of this section, R includes the permanent markdown in determining year-end retail selling prices. Therefore, the aggregate retail selling price of R’s ending inventory is $1,350 (15 * $90). Approximating LCM under the retail method, the value of R’s ending table inventory is $810 (60% * $1,350).

Example 2. (i) The facts are the same as in Example 1, except that R permanently reduces the retail selling price of all 40 tables to $50 per unit and the 15 tables on hand at the end of the year are marked for sale at that price. The additional $40 markdown is unrelated to a margin protection payment or other allowance.

(ii) Under paragraph (b)(3)(i)(B) of this section, R does not adjust the denominator of the cost complement for the markdown. Therefore, R’s cost complement is $2,400/$4,000, or 60%.

(iii) Under paragraph (b)(4) of this section, R includes the permanent markdowns in determining year-end retail selling prices. Therefore, the aggregate retail selling price of R’s ending inventory is $750 (15 * $50). Approximating LCM under the retail method, the value of R’s ending inventory is $450 (60% * $750).

Example 3. (i) The facts are the same as in Example 1, except that R computes the cost complement using the alternative method under paragraph (b)(3)(ii) of this section.

(ii) R reduces the numerator of the cost complement by the margin protection payments of $240 ($6 * 40) and reduces the denominator of the cost complement by the related markdowns of $400 ($10 * 40). Therefore, R’s cost complement is $2,160/$3,600, or 60%.

(iii) Under paragraph (b)(4) of this section, R includes the permanent markdown in determining year-end retail selling prices. Therefore, the aggregate retail selling price of R’s ending table inventory is $1,350 (15 * $90). Approximating LCM under the retail method, the value of R’s ending table inventory is $810 (60% * $1,350).

Example 4. (i) The facts are the same as in Example 1, except that R cannot determine the amount of its related markdowns and computes the cost complement using the alternative method under paragraph (b)(3)(ii)(C) of this section.
Section 7623.— Expenses of detection of underpayments and fraud, etc.

26 CFR 301.7623–1: Rewards and awards for information relating to violations of internal revenue laws

T.D. 9687

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 301

Awards for Information Relating to Detecting Underpayments of Tax or Violations of the Internal Revenue Laws

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: These regulations provide comprehensive guidance for the award program authorized under Internal Revenue Code (Code) section 7623. The regulations provide guidance on submitting information regarding underpayments of tax or violations of the internal revenue laws and filing claims for award, as well as on the administrative proceedings applicable to claims for award under section 7623. The regulations also provide guidance on the determination and payment of awards, and provide definitions of key terms used in section 7623. Finally, the regulations confirm that the Director, officers, and employees of the Whistleblower Office are authorized to disclose return information to the extent necessary to conduct whistleblower administrative proceedings. The regulations provide needed guidance to the general public as well as officers and employees of the IRS who review claims under section 7623.

DATES: Effective Date: These regulations are effective on August 12, 2014.

Applicability Date: Sections 301.7623–1, 301.7623–2, 301.7623–3, and 301.6103(h)(4)–1 apply to information submitted on or after August 12, 2014, and to claims for award under sections 7623(a) and 7623(b) that are open as of August 12, 2014. Section 301.7623–4 applies to information submitted on or after August 12, 2014, and to claims for award under section 7623(b) that are open as of August 12, 2014.

FOR FURTHER INFORMATION CONTACT: Melissa A. Jarboe at (202) 317–5437 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

Section 406 of the Tax Relief and Health Care Act of 2006 (the 2006 Act), Public Law 109–432 (120 Stat. 2922), enacted on December 20, 2006, amended section 7623 of the Code regarding the payment of awards to certain persons who provide information to the IRS relating to the detection of underpayments of tax or the detection and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same. In this preamble, the Treasury Department (Treasury) and the IRS use the phrase “underpayments of tax and violations of the internal revenue laws” as a shorthand reference for the range of civil and criminal matters to which information and, in turn, awards may relate under the statute. Section 406 redesignated the existing statutory authority to pay awards at the discretion of the Secretary of the Treasury as section 7623(a), and it added a new provision regarding awards to certain individuals as section 7623(b). Generally, section 7623(b) provides that qualifying whistleblowers will receive an award of at least 15 percent, but not more than 30 percent, of the collected proceeds resulting from the action with which the Secretary proceeded based on the information provided to the IRS by the whistleblower. In off–Code provisions, section 406 also addressed several award program administrative issues and established a Whistleblower Office within the IRS, which operates at the direction of the Commissioner, to analyze information received under section 7623, assign the investigation to the appropriate IRS office, and determine the amount of the award under section 7623(b).

In Notice 2008–4, 2008–1 CB 253 (January 14, 2008) (see § 601.601(d)(2)(ii)(b)),
Treasury and the IRS provided guidance on filing claims for award under section 7623. In the notice, Treasury and the IRS recognized that the award program authorized by section 7623(a) had been previously implemented through regulations appearing at § 301.7623–1 of the Procedure and Administration Regulations. The Internal Revenue Manual (IRM) provided additional guidance to IRS officers and employees on the award program authorized by section 7623(a). The notice provided that the IRS would generally continue to follow § 301.7623–1 and the IRM provisions for claims for award within the scope of section 7623(a), subject to certain exceptions listed in the notice. The notice also provided, however, that the regulations would not apply to the new award program authorized under section 7623(b). Instead, the notice provided interim guidance applicable to claims for award submitted under section 7623(b).

On March 25, 2008, Treasury and the IRS published proposed regulations, describing the circumstances and process in and by which officers and employees of the Treasury may disclose return information to whistleblowers (and their legal representatives, if any) in connection with written contracts for services relating to the detection of violations of the internal revenue laws or related statutes. Whistleblowers and legal representatives that receive return information pursuant to these regulations are subject to the civil and criminal penalty provisions of sections 7431, 7213, and 7213A for the unauthorized inspection or disclosure of return information. Treasury and the IRS finalized the proposed regulations on March 15, 2011 (the 2011 regulations).

In December 2008, the IRS revised IRM Part 25.2.2, updating policies and procedures concerning the handling of information, processing of claims for awards, and payment of awards under section 7623. The IRS also redelegated the authority to approve section 7623(a) awards to the Director of the Whistleblower Office, thereby promoting consistency across the full range of award decisions. Delegation Order 25–07 (Rev.1) (2008). In July 2010, the IRS further revised IRM Part 25.2.2 to provide detailed instructions to IRS officials and employees on the computation and payment of awards under section 7623 and to describe the administrative procedures applicable to claims for award under section 7623(b). The revised IRM introduced many guidance elements that are developed in these regulations, including definitions of key terms, the whistleblower administrative proceedings, the fixed percentage award framework and criteria for making award determinations, and rules on handling multiple and joint claimants.

On January 18, 2011, Treasury and the IRS published proposed regulations (76 FR 2852) clarifying the definitions of the terms proceeds of amounts collected and collected proceeds for purposes of section 7623 and providing that the provisions of existing § 301.7623–1(a), concerning refund prevention claims, apply to claims under both section 7623(a) and section 7623(b). The proposed regulations further provided that the reduction of an overpayment credit balance constitutes proceeds of amounts collected and collected proceeds for purposes of section 7623. Treasury and the IRS finalized the proposed regulations on February 22, 2012 (the 2012 regulations).

On December 28, 2012, Treasury and the IRS published proposed regulations in the Federal Register (77 FR 74798) providing comprehensive guidance with respect to section 7623 (the proposed regulations). The proposed regulations provided guidance on issues relating to the award program under section 7623 from the filing of a claim to the payment of an award, focusing on three major elements of the program: (i) the submission of information and filing of claims for award; (ii) the whistleblower administrative proceedings applicable to claims for award under section 7623; and (iii) the computational determination and payment of awards. The proposed regulations also provided definitions of key terms under section 7623 and confirmed that the Director, officers, and employees of the Whistleblower Office are authorized to disclose return information to the extent necessary to conduct whistleblower administrative proceedings. Treasury and the IRS received 859 comments in response to the proposed regulations. Commenters requested a public hearing, which was held on April 10, 2013. At the hearing, Treasury and the IRS received testimony from eight commenters. After consideration of the comments and hearing testimony, Treasury and the IRS made some modifications to the proposed regulations, which are discussed in detail later in this preamble. This Treasury decision adopts the proposed regulations, as modified. These final regulations provide comprehensive guidance for the award program authorized under section 7623.

Summary of Comments and Explanation of Revisions

Over 70 percent of the 859 written comments received were identical form letters. These one-page letters expressed support for the comments of Senator Charles Grassley, which were set out in a January 28, 2013, letter from Senator Grassley to Acting Treasury Secretary Neal Wolin, Acting IRS Commissioner Steven Miller, and Assistant Secretary (Tax Policy) Mark J. Mazur. Two other comments incorporated Senator Grassley’s January 28, 2013, letter in its entirety, and several comments offered general support for Senator Grassley’s views on the IRS Whistleblower Program. In addition to the comments referencing Senator Grassley’s letter or views on the Whistleblower Program, Treasury and the IRS received several substantive comments containing specific recommendations for the final regulations. Treasury and the IRS also received over 30 nearly identical comments expressing concern that the proposed regulations restricted the scope of the Whistleblower Program and awards, prohibited whistleblowers from collecting awards on technical grounds, limited the size of whistleblower awards, and failed to require the IRS to act on whistleblower claims. The issues raised in these comments are addressed in greater detail in the discussion that follows.

Treasury and the IRS also received over a hundred comments that referred generally to a need to protect and support whistleblowers and the IRS’s Whistleblower Program. These comments offered no further substantive discussion or specific recommendations with respect to the regulations. Treasury and the IRS, however, considered the general message behind these comments in considering
whether changes should be made to the proposed regulations. A few of the comments received suggested that the Chief Counsel, himself, should not be involved in the process of finalizing the regulations due to his professional experience prior to becoming Chief Counsel. After considering these comments, Treasury and the IRS found that the concerns expressed in the comments were unfounded. Accordingly, the Chief Counsel did not recuse himself from the process. Finally, Treasury and the IRS received a few comments that were completely unrelated to the proposed regulations and the IRS Whistleblower Program. These unrelated comments were outside the scope of the regulations and therefore are not discussed further in this preamble or these final regulations.

Information Disclosures in Whistleblower Administrative Proceedings—§ 301.6103(h)(4)–1

Under section 6103(a), returns and return information are confidential, unless an exception applies. Section 6103(h)(4) authorizes the disclosure of returns and return information in administrative or judicial proceedings pertaining to tax administration in certain circumstances. A whistleblower administrative proceeding under section 7623 is an administrative proceeding under section 6103(h)(4). Section 301.6103(h)(4)–1 of the proposed regulations specifically confirmed the authority of the Director, officers, and employees of the Whistleblower Office to disclose return information to the extent necessary to conduct whistleblower administrative proceedings. To minimize the potentially adverse consequences of the disclosure, and possible redisclosure, of return information, the proposed regulation provided that the Whistleblower Office will use confidentiality agreements in section 7623(b) whistleblower award determination administrative proceedings, as well as other safeguards, while still providing meaningful opportunities for whistleblowers to participate in whistleblower administrative proceedings.

In general, the comments received viewed these provisions favorably. One commenter recommended that section 6103 and § 301.6103 be amended to permit greater communication between the IRS and whistleblowers. Treasury and the IRS lack the authority to amend section 6103. Accordingly, the final regulations do not adopt this comment. Instead, in the proposed regulations, Treasury and the IRS took steps to expand the opportunities for communication between the IRS and whistleblowers within the confines of the IRS’s existing authority under section 6103. For example, Treasury and the IRS provided for whistleblower administrative proceedings, in part, to increase the IRS’s ability to communicate with whistleblowers. Some comments suggested that whistleblower administrative proceedings should begin earlier, and these comments are more fully addressed in the discussion of § 301.7623–3. Treasury and the IRS determined that the proposed regulations struck an appropriate balance among minimizing possible redisclosures of confidential return information, providing meaningful opportunities for claimants to participate in the administrative process, and placing an undue burden on the Whistleblower Office. After consideration of the comments, the proposed regulation under section 6103 is adopted without substantive change.

Submitting Information and Filing Claims for Award—§ 301.7623–1

This final regulation provides guidance on submitting information to the IRS and filing claims for award with the Whistleblower Office. The regulation is intended to clarify the process whistleblowers should follow to be eligible to receive awards under section 7623. The final regulation, in large part, tracks the rules that Treasury and the IRS have previously provided, as set forth in the 2012 regulations, the proposed regulations, Notice 2008–4, and the IRM. The comments received and any changes to proposed § 301.7623–1 are discussed in the sections that follow.

Terminology for Individuals who Submit Information and Claim an Award

Under section 7623(a), the Secretary possesses the discretionary authority to pay awards for information necessary to detect underpayments of tax or violations of the tax laws. Section 7623(b) further requires the payment of awards to individuals in certain circumstances. The proposed regulations used both the term “individual” and the term “claimant” in various respects. Generally, the terminology in the proposed regulations was designed to mimic the statute’s use of the term “individual(s).” One commenter suggested that the final regulations should use the term “claimant” throughout and eliminate all references to the term “individual.” The final regulations recognize, however, that not all individuals who submit information to the IRS regarding tax non-compliance become award claimants. To achieve consistency with Treas. Reg. § 301.6103(n)–2 and reduce any confusion caused by the use of several terms, Treasury and the IRS changed almost all of the references to “individual” or “claimant” to “whistleblower” in the final regulations. In some instances, however, the final regulations still use the term “individual” to mimic the statute. These changes are not intended to be substantive in nature.

List of Ineligible Whistleblowers

Section 7623 does not specifically exclude any whistleblower from filing a claim for award, although awards under section 7623(b) are limited to individuals. Moreover, section 7623(b)(3) requires the Whistleblower Office to deny an award to a whistleblower convicted of a crime arising from the whistleblower’s role in planning and initiating the actions that led to the underpayment of tax or violations of the internal revenue laws. The regulations in effect under section 7623 at the time of the 2006 amendments to the statute, however, restricted the eligibility of Federal employees to file claims for award. The 2006 amendments to section 7623 did not address, and thus did not seek to change, the rule of Federal employee ineligibility. In the proposed regulations, the IRS identified as ineligible certain categories of individuals that would have access to return information of third parties by virtue of their relationship with the Federal Government. These categories were identified in Notice 2008–4, and their exclusion was based upon the understanding that such individuals have a pre-existing legal or ethical obligation to disclose any violations of the internal revenue laws. For
should continue to reflect the longstanding gible whistleblowers. Treasury and the commission from the categories of ineligible or members of a Federal or State body or related to State and local taxpayers should be ineligible. The other commenter suggested that the only whistleblowers excluded from receiving awards under the statute are those convicted of a crime for planning and initiating, and thus the IRS should not identify any ineligible whistleblowers. This commenter also expressed concern that the exclusion of individuals required to disclose (or to not disclose) information under Federal law was too vague and would discourage whistleblowers from submitting information. Finally, the commenter that suggested the proposed regulations should be adopted without change noted that individuals should not be eligible to receive awards after obtaining information in the course of their employment as a Federal employee.

The final regulations address the concerns raised by commenters that the categories of ineligible claimants included in the proposed regulations was too broad, and one comment recommending that the proposed regulations should be finalized without change. One commenter suggested that, with respect to State and local government employees, only those that have access to Federal tax return records related to State and local taxpayers should be ineligible. The other commenter suggested that the only whistleblowers excluded from receiving awards under the statute are those convicted of a crime for planning and initiating, and thus the IRS should not identify any ineligible whistleblowers. This commenter also expressed concern that the exclusion of individuals required to disclose (or to not disclose) information under Federal law was too vague and would discourage whistleblowers from submitting information. Finally, the commenter that suggested the proposed regulations should be adopted without change noted that individuals should not be eligible to receive awards after obtaining information in the course of their employment as a Federal employee.

Treasury and the IRS received two comments suggesting that the list of ineligible or excluded claimants included in the proposed regulations was overbroad, and one comment recommending that the proposed regulations should be finalized without change. One commenter suggested that, with respect to State and local government employees, only those that have access to Federal tax return records related to State and local taxpayers should be ineligible. The other commenter suggested that the only whistleblowers excluded from receiving awards under the statute are those convicted of a crime for planning and initiating, and thus the IRS should not identify any ineligible whistleblowers. This commenter also expressed concern that the exclusion of individuals required to disclose (or to not disclose) information under Federal law was too vague and would discourage whistleblowers from submitting information. Finally, the commenter that suggested the proposed regulations should be adopted without change noted that individuals should not be eligible to receive awards after obtaining information in the course of their employment as a Federal employee.

The final regulations address the concerns raised by commenters that the categories of ineligible claimants included in the proposed regulations was too broad, and one comment recommending that the proposed regulations should be finalized without change. One commenter suggested that, with respect to State and local government employees, only those that have access to Federal tax return records related to State and local taxpayers should be ineligible. The other commenter suggested that the only whistleblowers excluded from receiving awards under the statute are those convicted of a crime for planning and initiating, and thus the IRS should not identify any ineligible whistleblowers. This commenter also expressed concern that the exclusion of individuals required to disclose (or to not disclose) information under Federal law was too vague and would discourage whistleblowers from submitting information. Finally, the commenter that suggested the proposed regulations should be adopted without change noted that individuals should not be eligible to receive awards after obtaining information in the course of their employment as a Federal employee.

The proposed regulations did not, however, require that a whistleblower submit a claim that the individual intends to submit a claim for award based on the information submitted. In this regard, the proposed regulations provided that a whistleblower submitting a claim should identify a person and describe and document the facts supporting the whistleblower’s belief that the person owes taxes or violated the tax laws.

One commenter suggested that the proposed regulations improperly required whistleblowers to identify a specific taxpayer in the submission of information. The proposed regulations did not, however, require that a whistleblower’s information identify a taxpayer by name. The IRS and the Whistleblower Office must be able to identify a taxpayer in order to proceed with an action and, ultimately, to determine an award. The more identifying information that a whistleblower includes in the submission, the more likely it is that the submission will be considered to identify a taxpayer. Treasury and the IRS determined that the concerns raised in the comment are adequately addressed by the language in the proposed regulations. Accordingly, these regulations retain the rule from the proposed regulations.

Submission of Information

Any individual may submit information to the IRS regarding suspected underpayments of tax or violations of the internal revenue laws. The proposed regulations provided that the information submitted must be specific and credible if the individual intends to submit a claim for award based on the information submitted. In this regard, the proposed regulations provided that a whistleblower submitting a claim should identify a person and describe and document the facts supporting the whistleblower’s belief that the person owes taxes or violated the tax laws.

One commenter suggested that the proposed regulations improperly required whistleblowers to identify a specific taxpayer in the submission of information. The proposed regulations did not, however, require that a whistleblower’s information identify a taxpayer by name. The IRS and the Whistleblower Office must be able to identify a taxpayer in order to proceed with an action and, ultimately, to determine an award. The more identifying information that a whistleblower includes in the submission, the more likely it is that the submission will be considered to identify a taxpayer. Treasury and the IRS determined that the concerns raised in the comment are adequately addressed by the language in the proposed regulations. Accordingly, these regulations retain the rule from the proposed regulations.

Penalty of Perjury Requirement

To form the basis for an award under section 7623(b), section 7623(b)(6)(C) requires that information be submitted under penalty of perjury. The proposed reg-
sistance from a whistleblower or the whistleblower’s representative. The proposed regulations provided that such assistance shall be at the direction or control of the Whistleblower Office, the IRS, or the IRS Office of Chief Counsel. The proposed regulations also referred to Treas. Reg. § 301.6103(n)–2 for rules regarding written contracts between the IRS and whistleblowers or their representatives.

Several commenters suggested that the regulations should do more to improve and expand communications between the IRS and whistleblowers. Many commenters specifically addressed the IRS’s use of section 6103(n) contracts. Commenters often expressed concern that the IRS does not effectively utilize section 6103(n) contracts and suggested that the IRS should make better use of its section 6103(n) contract authority to facilitate increased communication with, and participation by, whistleblowers. One commenter suggested that the regulations should clarify when the IRS will use its contract authority and establish protocols for its use. This commenter also suggested that the regulations could do more to clarify when and what type of information can be shared with the whistleblower so that he or she may assist the IRS. Another commenter suggested that the regulations should require the Whistleblower Office and the IRS Office of Chief Counsel to request assistance by conducting a debriefing of the whistleblower in all cases.

As noted, returns and return information are confidential pursuant to section 6103, unless an exception applies. In a 2012 memorandum to the IRS Operating Divisions, the IRS stressed the use of methods of communicating with whistleblowers within the framework of section 6103. IRS Whistleblower Program Memorandum (Deputy Commissioner for Services and Enforcement Steven T. Miller, June 20, 2012) (the 2012 memo). The 2012 memo recognized the value of whistleblower debriefings and stated the expectation that debriefings will be the rule, not the exception. The IRS routinely debriefs whistleblowers to clarify and develop the information provided. Although not discussed in the 2012 memo, the IRS has also relied, and will continue to rely, on section 6103(k)(6) to disclose information to whistleblowers when the disclosure is necessary to obtain information from the whistleblower. These investigatory disclosures are a routine element of the IRS’s enforcement activities. The 2012 memo also noted that section 6103(n) contracts may be used when disclosure of taxpayer information is necessary to obtain a whistleblower’s expertise into complex technical or factual issues. Although the IRS’s need for this level of expertise into complex issues arises less commonly than the need for section 6103(k)(6) investigative disclosures, the IRS Operating Divisions will use this tool as needed. Specific issues regarding the use of section 6103(n) contracts by the IRS and whistleblowers are beyond the scope of these regulations. These regulations do not specifically address section 6103(n) contracts because they are already provided for in regulations under section 6103, as appropriately reflected by the cross reference contained in the proposed regulations and these regulations. Nevertheless, debriefings, section 6103(k)(6) disclosures, and section 6103(n) contracts are not the only methods by which the IRS communicates with whistleblowers. Later in the life cycle of the underlying tax matter, the IRS Office of Chief Counsel may, under section 6103(h)(4), seek assistance from a whistleblower in litigating a case. For example, the IRS Office of Chief Counsel has relied on, and will continue to rely on, whistleblowers as potential witnesses in Tax Court cases, but only as needed and only following appropriate consideration of whistleblower confidentiality concerns, as discussed later in this preamble. Finally, as discussed both earlier and later in this preamble, these regulations provide whistleblower administrative proceedings that will, in many cases, enable two-way communications with whistleblowers before the IRS makes the award determination.

Confidentiality of Whistleblowers

Section 7623 does not provide any protections regarding the identification of whistleblowers. Treasury and the IRS, however, are very sensitive to the legitimate concerns whistleblowers have with protecting their identities. In the Administration’s Fiscal Year 2014 and 2015 Revenue Proposals, Treasury recommended amending section 7623 to explicitly protect whistleblowers from retaliatory actions, consistent with the protections currently available to whistleblowers under the False Claims Act. Moreover, existing Treas. Reg. § 301.7623–1(e) provides that “[n]o unauthorized person will be advised of the identity of an informant.” The proposed regulations reaffirmed the commitment of Treasury and the IRS to safeguard the identity of whistleblowers who submit information under section 7623. Under the proposed rules, the IRS reaffirmed that it will use its best efforts to: (i) prevent the disclosure of a whistleblower’s identity; and (ii) notify a whistleblower prior to any disclosure. One commenter suggested that the final regulations should go further and require notification to a whistleblower prior to any disclosure. Another commenter suggested that whistleblowers should be allowed to opt out of the informant privilege. This commenter suggested that allowing the whistleblower to opt out of the informant’s privilege would decrease the amount of time for an administrative action because it would allow the IRS to use and rely upon documents provided by the whistleblower, rather than seeking to independently gather the documents.

The informant privilege allows the Government to withhold the identity of a person that provides information about violations of law to those charged with enforcing the law. The informant privilege is held by the Government, not the informant, and is not an absolute privilege. There may be instances when, after careful deliberation and high-level IRS approval, the disclosure of the identity of a whistleblower may be determined to be in the best interests of the Government. Nonetheless, in such cases, the IRS first carefully considers and weighs the potential risks to the whistleblower and the Government’s need for the disclosure, and looks for alternative solutions.

The final regulations reflect the determination of Treasury and the IRS that preventing the disclosure of whistleblower information is of critical importance not only to whistleblowers, but also to the IRS’s whistleblower program. The IRS has implemented a multi-level review process to ensure that the identities of whistleblowers are disclosed only after
careful consideration. The IRS will continue to use its best efforts to prevent disclosures and to provide notification prior to any disclosure. The IRS recognizes, however, that despite its best efforts, it may not always be possible to provide such notification.

In some instances, whistleblowers have consented to the disclosure of their identities in the hope that the IRS will proceed with a tax case more quickly. Even when a whistleblower consents to disclosure, however, disclosing the whistleblower’s identity may not be in the Government’s best interest. Moreover, a whistleblower cannot unilaterally opt out of the informant privilege because the privilege is held by the Government. Finally, it is the longstanding practice of the IRS to justify tax adjustments through information obtained independently of the whistleblower. This enables the IRS to better defend tax adjustments in court and supports the IRS’s sound administration of the tax case. As such, the IRS will act on specific and credible information regarding tax compliance issues when that information can be corroborated, as part of a balanced tax enforcement program, and will not forgo this process at the whistleblower’s request to expedite a potential award. Accordingly, these regulations retain the rule from the proposed regulations.

Electronic Claim Filing

Section 7623 does not require the submission of information or claims for an award to be in a particular format. To claim an award for information provided to the IRS, the proposed regulations provided that a whistleblower must file a formal claim for award by completing and sending Form 211, “Application for Award for Original Information,” to the Internal Revenue Service, Whistleblower Office, at the address provided on the form, or by complying with other claim filing procedures as may be prescribed by the IRS in other published guidance. Currently, a whistleblower cannot file a Form 211 electronically. The proposed regulations solicited comments on whether electronic claim filing would be appropriate and beneficial to whistleblowers, and if so, what features should be included in an electronic claim filing system.

Treasury and the IRS received several comments suggesting that such procedures would be beneficial, but some commenters expressed concern with how an electronic claim filing system would be implemented. Based upon the varied comments received, Treasury and the IRS have decided not to include specific guidance on electronic claim filing in the final regulations. The final regulations adopt the proposed rule and require whistleblowers to file a formal claim for award by completing and sending a Form 211 to the IRS. The language in the final regulations does, however, allow for the IRS to specify an alternative submission method pursuant to additional guidance. If Treasury and the IRS implement electronic claim filing, the comments received on the proposed regulations regarding implementation will be considered and addressed in future guidance.

Definitions of Key Terms—§ 301.7623–2

These final regulations define several key terms for purposes of determining awards under section 7623 and the corresponding regulations. These terms include: action, administrative action, judicial action, proceeds based on, related action, collected proceeds, amount in dispute, and gross income. Two other key terms, planned and initiated and final determination of tax, are described and defined in § 301.7623–4 of these regulations. The definitions are intended to facilitate the IRS’s administration of the whistleblower award program in a manner that is consistent with the statutory language. As described later in this preamble, several of the definitions, including the definition of the terms proceeds based on, related action, and collected proceeds, build on definitions contained in Notice 2008–4, the 2012 regulations, and the IRM. The comments received and any changes to the definitions of these terms are addressed in the sections that follow.

Administrative Action

The application of section 7623(b) hinges on whether the IRS proceeds with an action, and more specifically, an administrative or judicial action, against a taxpayer. Section 7623 does not, however, define the terms action, judicial action, or administrative action. The proposed regulations defined an administrative action as all, or a portion of, an IRS civil or criminal proceeding against a person that may result in collected proceeds. Examples of an administrative action include an examination, a collection proceeding, a status determination proceeding, or a criminal investigation. And, as noted, under the proposed regulations, an administrative action can be a discrete portion of an IRS civil proceeding. For example, the examination of a single issue, within a multi-issue examination, can constitute an administrative action. In such a case, determinations such as whether the IRS proceeded with the action based on the whistleblower’s information or the extent of the whistleblower’s substantial contribution to the action will be made by reference to just the discrete and relevant portion of the examination to which the information provided relates.

One commenter suggested that an administrative action should begin with the filing of a claim for an award. Although the commenter made this suggestion in the context of the definition of “administrative action,” Treasury and the IRS believe that it relates to the whistleblower award administrative proceedings discussed later in this preamble. Some commenters suggested that the definition of the term “administrative action” should be broader. More specifically, one commenter suggested that the list of examples should include making an assessment and another commenter suggested that the term “administrative action” should encompass all actions taken by the IRS to initiate taxpayer compliance by any means. Finally, commenters expressed concern that a whistleblower would not be entitled to an award when the whistleblower’s information related to an issue that was already being examined, but resulted in the IRS making a greater assessment than the IRS would have made without the whistleblower’s information. Commenters raised a similar concern in discussing the proposed regulations’ definition of the term proceeds based on. This concern is addressed in that section of this preamble.

Off-code provisions of the 2006 Act explicitly provide that the IRS will ana-
lyze information received under section 7623 and investigate the matter. Given that this requirement must be satisfied by the IRS with respect to all information provided, it follows that the techniques and tools used by the IRS to do the analysis and investigation of the whistleblower’s claim cannot in and of themselves provide a basis—they cannot be the administrative action—that supports an award determination. Nonetheless, if a whistleblower’s information contributes to the IRS’s use of these techniques and tools, for example, the issuance of a summons or Information Document Request, and these intermediate steps result in an administrative action, as defined in the regulations, then the IRS will determine whether it proceeded with that resulting administrative action based on the information, as described further in the discussion of the definition of proceeds based on. Similarly, an assessment is a bookkeeping entry employed by the IRS to reflect a determination that results from an administrative action within the meaning of section 7623. Because an assessment merely reflects the determination that results from an administrative action, it is not appropriate to include the making of an assessment in the definition of the term administrative action. Essentially, the definition of administrative action is broadly analogous to the definition of judicial action, as each term focuses on a case against a taxpayer that may result in collected proceeds, rather than on any particular tools or techniques used to conduct the case. After considering the comments on the definition of administrative action, the definition in the proposed regulations is adopted without change. Treasury and the IRS did, however, address some of the concerns raised by the comments on this definition through changes to the definition of proceeds based on, as described in the discussion that follows.

Proceeds Based On

Section 7623(b) provides that if the Secretary proceeds with an administrative or judicial action based on the information provided by a whistleblower, then the whistleblower will receive an award from the collected proceeds resulting from the action (including any related actions). Under the proposed regulations the IRS proceeds based on information provided by an individual only when the IRS: (i) initiates a new action; (ii) expands the scope of an ongoing action; or (iii) continues to pursue an ongoing action, that the IRS would not have initiated, expanded the scope of, or continued to pursue, respectively, but for the information provided by the individual. The IRS does not proceed based on when the IRS merely analyzes the information provided by the individual and investigates the matter.

Commenters to the proposed regulations generally expressed concern that the regulatory language narrowed the scope of the statute by limiting the instances in which the Whistleblower Office will determine that the IRS proceeded based on a whistleblower’s information. Some commenters disagreed with the use of the words “only” and “but for” in the proposed regulations’ definition and suggested removing this language. One commenter recommended removing the last sentence in the proposed regulations’ definition—“The IRS does not proceed based on when the IRS merely analyzes the information provided by the individual and investigates the matter.” Some commenters suggested that the IRS should be considered to proceed based on information anytime that the IRS “uses” the information, or more specifically, anytime the information is transmitted by the Whistleblower Office to an IRS field office for further investigation. Some commenters suggested that the definition needed to specifically include instances when a whistleblower’s information materially or substantially assists in or significantly contributes to the IRS’s detection and recovery of tax. As noted in the discussion of the definition of administrative action, some commenters expressed concern that a whistleblower would not be entitled to an award when the whistleblower’s information related to an issue that was already being examined or was included in a general audit plan, but resulted in the IRS making a greater assessment than the IRS would have made without the whistleblower’s information. Similarly, some commenters expressed concern that under the proposed regulations’ definition, the IRS could use a whistleblower’s information but assert that it would have acted without the information and therefore determine that the IRS did not proceed based on the information.

As noted, the off-Code provisions of the 2006 Act require the IRS to analyze the information provided by the whistleblower (in the Form 211 and otherwise, such as through debriefs) and investigate the matter. As a result, it follows that for the IRS to proceed based on the information provided, the IRS must do more than this analysis or investigation. Therefore, Treasury and the IRS retained this explanatory language in the final regulations. Treasury and the IRS recognize, however, that, by listing exclusive actions taken by the IRS, the proposed regulations created the appearance that individuals who provide information that is not only used by the IRS, but is in fact critical to sustaining tax adjustments, might not receive awards. Accordingly, these final regulations adopt a general standard for when the IRS proceeds based on information provided—when the information substantially contributes to the action—and the list of exclusive actions are cited as examples of when the information provided may substantially contribute to an action. In addition, the final regulations remove the word “only” from the definition. Accordingly, under the final regulations, the Whistleblower Office must determine when the information provided substantially contributed to the underlying action, and this determination will depend on the facts and circumstances of each individual case. Nevertheless, the final regulations provide additional examples to clarify the operation of the rule. These examples illustrate that the whistleblower’s information substantially contributes to the underlying action if it leads to an examination, an expansion of an issue already being examined, an expansion of the examination to another year, or an additional adjustment. The examples also illustrate that the whistleblower’s information does not substantially contribute to the underlying action if that information merely supports information obtained independently by the IRS.

Related Action

Under section 7623(b), when the IRS proceeds with an action based on a
whistleblower’s information, the whistleblower receives an award from the collected proceeds resulting from the action (including any related actions). Under the proposed regulations the term related action was limited to: (i) a second or subsequent action against the person(s) identified in the information provided and subject to the original action if, in the second or subsequent action, the IRS proceeds based on the specific facts described and documented in the information provided; and (ii) an action against a person other than the person(s) identified in the information provided and subject to the original action if: (A) the other, unidentified person is directly related to the person identified in the information provided; (B) the facts relating to the underpayment of tax or violations of the internal revenue laws by the other person are substantially the same as the facts described and documented in the information provided (with respect to the person(s) subject to the original action); and (C) the IRS proceeds with the action against the other person based on the specific facts described and documented in the information provided.

Under the proposed regulations an unidentified person was directly related to the person identified in the information provided if the IRS can identify the unidentified person using only the information provided (without first having to use the information provided to identify any other person or having to independently obtain additional information).

The definition of the term related action contained in the proposed regulations defined which actions may be included for purposes of computing collected proceeds by requiring a clear link between the original action and the other, related action(s). This clear link required: (i) a direct relationship between the person identified in the information provided and subject to the original action and the person(s) subject to the other action(s); and (ii) a substantial similarity between the specific facts contained in the information provided and the relevant facts of the other action(s).

In general, comments received on the definition of related action in the proposed regulations, including the form letters, suggested that the definition was too restrictive. The commenters suggested that instead of requiring a direct relationship, the IRS should conduct a proximate cause analysis, under which related actions are those actions with which the IRS proceeds in a natural and continuous sequence from the actions first taken in response to a whistleblower’s information. One commenter suggested that a direct relationship or one-step rule is inconsistent with the ordinary meaning given to the term “related.” Another commenter suggested that a related action should be any issue that is related to the whistleblower’s submission with respect to the tax year, the taxpayer, or the tax issue. This commenter expressed concern that the definition of related action would exclude subsequent years of the same taxpayer for which the same issue exists, unless the information provided contained specific facts and documentation from those subsequent years. Two other commenters suggested that the language at Prop. Reg. § 301.7623–2(c)(i) describes an original action rather than a related action. These commenters suggested that when the IRS initiates a second or subsequent action against a person identified in the information provided by the whistleblower based on the specific facts described and documented in the information provided, then the IRS has proceeded based on the information and there is therefore no need to look to the definition of related action to determine the whistleblower’s eligibility for an award.

After considering the comments, Treasury and the IRS determined that the concern that whistleblowers would not be given full credit for the information provided was partially addressed through the changes made to the definition of the term proceeds based on in the final regulations and described earlier in this preamble. Moreover, the broadened language of the definition of the term proceeds based on in the final regulations encompassed and made redundant the language in Prop. Reg. § 301.7623–2(c)(i) that focused on actions involving subsequent tax years and, thus, it was removed from the final regulations. The corresponding example illustrating the application of the rules to actions involving subsequent tax years moved with the rule to the definition of proceeds based on. Finally, Treasury and the IRS made several non-substantive revisions to the language of the definition of related action.

The final regulations retain the proposed regulations’ requirement of a clear link between the original action and any other, related action(s), which requires: (i) a substantial similarity between the specific facts contained in the information provided and the relevant facts of the other action(s); and (ii) a relationship between the person identified in the information provided and subject to the original action and the person(s) subject to the other action(s). This conjunctive test excludes from the definition of related action actions that are merely factually similar to the original action, for example, actions against unidentified taxpayers that merely engaged in substantially similar transactions to the transaction identified in the information provided. The relationship test in the second prong thus retains a one-step rule: the taxpayer subject to the related action can be no more than one step removed—in terms of identification by the IRS—from a taxpayer identified in the information provided. In addition, the final regulations at § 301.7623–1(c)(1) provide that certain information submissions relating to pass-through entities and firms will be considered to have identified certain persons who were not explicitly identified in the information provided.

Despite commenters’ requests that the definition should be even broader and more subjective, Treasury and the IRS determined that the clear link approach is a reasonable interpretation and application of the language contained in section 7623. Treasury and the IRS determined that the final regulations’ definition of the term related action finds a reasonable middle ground between overly narrow and overly broad interpretations. For example, the term could be given a narrow application, encompassing only actions that follow from the action with which the IRS proceeded based on the information and actually produce collected proceeds. Given that many administrative and judicial actions produce no collected proceeds, this interpretation would give effect to the statutory language in such cases by ensuring that whistleblowers would receive awards when any related actions produce collected proceeds. Treasury and the IRS have concluded that such a definition
would be too narrow because, under this interpretation, a related action (such as a collection action) would be required in almost every case. At the other end of the spectrum, the term related action could be broadly interpreted to include every similar fact pattern entered into by any taxpayer at any time. Such an interpretation is overly broad and would be impossible for the IRS to administer because it would require the IRS to keep whistleblower claims open and search for similar fact patterns in perpetuity.

Instead, these final regulations adopt a definition that finds a reasonable middle ground. The definition encompasses a finite group of actions that, while likely unknown to the whistleblower, are objectively connected to the information provided. Treasury and the IRS adopt the one-step approach of the proposed regulations because, by setting a clear standard for the Whistleblower Office to apply, the one-step approach is administrable. Tort law concepts, on the other hand, are rarely applied to tax, and the appropriate application of such concepts is unclear. Finally, based on the IRS’s experience administering whistleblower claims, Treasury and the IRS believe that, in most cases, the results of a proximate cause analysis and a one-step approach are likely to be the same. Ultimately, Treasury and the IRS determined that the definition in the final regulations provides an administrable, objective test that strikes an appropriate balance between the IRS’s and the whistleblower’s substantial contributions.

**Collected Proceeds**

Section 7623(a) provides the Secretary with the authority to pay such sums as he deems necessary from proceeds of amounts collected based on information provided to the Secretary when the information relates to the detection of underpayments of tax or the detection and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same. Section 7623(b) requires the Secretary to pay awards to whistleblowers if the Secretary proceeds with an administrative or judicial action that results in collected proceeds based on information provided by the whistleblower. The definition of collected proceeds contained in the proposed regulations built on the definition contained in the 2012 regulations. The definition in the proposed regulations restated the rule from those final regulations that collected proceeds include: tax, penalties, interest, additions to tax, and additional amounts collected because of the information provided; amounts collected prior to receipt of the information provided if the information results in the denial of a claim for refund that otherwise would have been paid; and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided. The definition also addressed refund netting, criminal fines that must be deposited into the Victims of Crime Fund, and a computational rule for determining collected proceeds. Finally, consistent with provisions in the IRM, the proposed regulations provided that amounts recovered under the provisions of non-Title 26 laws do not constitute collected proceeds, because the language of section 7623 authorizes awards for detecting underpayments of tax and violations of the internal revenue laws. Several commentators addressed various aspects of the definition of collected proceeds contained in the proposed regulations. The substance of these comments and the determinations of Treasury and the IRS are set out in detail in the preamble discussion that follows.

**Timing Issues and Treatment of Tax Attributes Including Net Operating Losses (NOLs)**

Section 7623 provides for the payment of awards from collected proceeds, but it does not specifically address the treatment of claims that involve tax attributes that do not result in collected proceeds for many years, if ever. The proposed regulations provided a computational rule that reflects the discussion contained in the preamble to the 2012 regulations. There, Treasury and the IRS noted that tax attributes such as NOLs do not represent amounts credited to the taxpayer’s account that are directly available to satisfy current or future tax liabilities or that can be refunded. Rather, tax attributes such as NOLs are component elements of a taxpayer’s liability. The disallowance of an NOL claimed by a taxpayer may affect the taxpayer’s liability and, in the context of a whistleblower claim, may result in collected proceeds or it may be carried forward 20 years and expire, thus never resulting in collected proceeds. To enable the IRS to administer the Whistleblower Program, the proposed regulations’ computational rule provided that, after there has been a final determination of tax, the IRS would compute the amount of collected proceeds taking into account all information known with respect to the taxpayer’s account (including all tax attributes such as NOLs). Under the proposed regulations, any tax attributes that have been used at the time of the final determination of tax may affect the award amount. The proposed regulations reflected Treasury and the IRS’s attempt to make an award determination and pay any resulting award as soon as possible after proceeds are collected. The proposed regulations also reflected Treasury and the IRS’s determination that tracking tax attributes into the future after payment of an award would impose significant costs and a heavy administrative burden. Thus, the proposed rule attempted to balance the whistleblower’s interest in receiving a timely award determination and payout with the Government’s interest in maintaining an administrable program.

Several commentators suggested that the proposed regulations did not strike the appropriate balance and recommended that tax attributes, specifically NOLs, should be included in the definition of collected proceeds. The commentators generally expressed concern that under the proposed regulations, a whistleblower might not receive credit for proceeds collected after the final determination of tax, as a result of tax attributes being carried forward to reduce a later liability. Some commentators suggested that the IRS should attempt to calculate and apply a present value to determine an award amount for any unused tax attributes. Other commentators recommended that, in the final regulations, the IRS should agree to track tax attributes for a specific period of time, for example, ten years. One commenter suggested that after the period of time that the IRS had agreed to track, the whistleblower and the IRS could enter into a settlement agreement wherein the whistleblower could agree to the amounts computed as
of that date and waive any rights to a future appeal. Finally, one commenter recommended that the IRS should allow whistleblowers to submit a new claim for award when the whistleblower was aware of subsequently collected proceeds.

In light of the comments received, Treasury and the IRS have reconsidered the approach in the proposed regulations. These final regulations provide that the Whistleblower Office will monitor the relevant taxpayer account or accounts until the IRS receives collected proceeds as a result of a reduction in the tax attribute, or the taxpayer’s ability to apply the tax attribute expires unused. For example, if a NOL is reduced as a result of actions taken based on whistleblower information, the Whistleblower Office will periodically review the taxpayer account to determine whether future year tax payments are made that would not have been made if the NOL had not been reduced. Under the approach in the final regulations, awards will be paid on any such post-determination collected proceeds. If the NOL carry-forward period expires before the reduced NOL results in a tax payment, no award will be payable.

The decision to monitor future year activities for impact on the amount of collected proceeds will apply to all claims, not just claims involving NOLs. As a result, in some cases, the Whistleblower Office may defer action on an award claim. For example, whistleblower information may result in IRS action to disallow a taxpayer’s treatment of the purchase of an asset as an expense in Year 1, because the asset should be capitalized and depreciated in accordance with the applicable depreciation schedule. As a result, taxable income in Year 1 is increased by the purchase price of the asset, less allowable Year 1 depreciation. Taxable income in future years would be reduced by the allowable depreciation for each year, until the asset is fully depreciated (or sold or otherwise disposed of). When this occurs, the Whistleblower Office will monitor the taxpayer’s account to determine whether future year offsetting reductions in liability related to the Year 1 tax liability occur, and will reduce the amount of collected proceeds accordingly.

The adoption of a monitoring approach in the final regulations, however, is only intended to explicitly enable the IRS to make an additional award payment when a tax attribute produces collected proceeds after an award has been determined, as described in the preceding paragraphs. It is not intended to, and does not in any way, limit the Whistleblower Office’s discretion to aggregate or disaggregate claims, nor does it provide a basis for, or enable the IRS to make, mandatory, partial, or ongoing award determinations and payments every time the IRS collects some amount of proceeds. In other words, monitoring does not alter the general rule that no award will be paid until there has been a final determination of tax, as defined in the final regulations.

**Amounts Collected Under Title 26**

Section 7623 of Title 26 provides for awards for information leading to detection of underpayments of tax or violations of the internal revenue laws. The proposed regulations provided that amounts recovered under the provisions of non-Title 26 laws do not constitute collected proceeds for award purposes. The majority of comments, including the form letters, suggested that such amounts, specifically amounts collected under Title 18 and Title 31, should be included in collected proceeds. Many of the comments suggested that not including amounts collected under Title 18 and Title 31 eliminates a whistleblower’s incentive to provide information on violations under those titles and could reduce the number of whistleblowers willing to provide such information to the IRS. The comments generally suggested that collected proceeds should include any amounts that are collected by the IRS. A few comments also suggested that the statutory language “collected proceeds (including penalties, interest, additions to tax, and additional amounts)” means that Congress intended for collected proceeds to be a broad and inclusive concept consisting of any amounts collected by the IRS and any amounts to be collected by the IRS in the future. Similarly, one commenter suggested that the use of the word “any” throughout the statute was another reason that the statute and Congress’ intent with respect to the statute should be interpreted broadly.

Like section 7623, the internal revenue laws are contained in Title 26 and implementing guidance is issued under that title. Although the IRS may collect penalties for violations of Title 31, Money and Finance, and seize property under Title 18, Crimes and Criminal Procedure, those penalties and seizures do not relate to “underpayments of tax,” may be imposed independently of whether a tax underpayment occurs, and are not related to violations of the internal revenue laws under Title 26. Moreover, administrative actions under Title 26 and Title 31 entail separate administrative proceedings, and administrative distinctions persist even when the actions proceed at the same time. In some cases, the IRS may collect penalties for failure to file Form 114, “Report of Foreign Bank and Financial Accounts” (FBAR), which is an information reporting requirement under Title 31 the violation of which does not necessarily result in an underpayment of tax. As a result, FBAR penalties do not constitute collected proceeds. Moreover, sections 5323(a) and 9703(a) of Title 31 provide independent authority, separate and apart from section 7623, for the payment of rewards for information relating to certain violations of Title 31 or Title 18. Finally, the terms “additions to tax” and “additional amounts” have long been used to encompass the penalties under Subchapter A of Chapter 68 of Subtitle F of the Code and they are routinely used in forms issued by the IRS pursuant to Title 26 to refer to those penalties. They do not provide any support for treating non-Title 26 amounts as collected proceeds. The comments received did not change the view of Treasury and the IRS that section 7623 only authorizes awards for amounts collected under the internal revenue laws, which are contained in Title 26, the Internal Revenue Code. Treasury and the IRS recognize the commenters’ concern that the statute may reduce the incentive to provide information to the IRS regarding non-Title 26 violations. The language of the statute does not, however, support a broader, more-inclusive definition of collected proceeds. Treasury and the IRS instead emphasize that when the IRS collects amounts based on information related to non-Title 26 violations and also collects related proceeds under Title 26,
the Title 26 collected proceeds may form the basis for an award under section 7623. Moreover, depending on the facts and circumstances, the non-Title 26 proceeds may form the basis for an award under a whistleblower award program other than the one authorized by section 7623.

**Amounts Deposited in the Victims of Crime Fund**

Under the Victims of Crimes Act of 1984, criminal fines that are imposed on a defendant by a district court shall be deposited into the Victims of Crime Fund. See 42 U.S.C. 10601(b)(1). Although the Victims of Crime Act does except certain specified amounts that are payable to other sources pursuant to other statutory mandates, amounts payable under section 7623 are not included in the exceptions. The proposed regulations provided that criminal fines that must be deposited into the Victims of Crime Fund do not constitute collected proceeds. One commenter suggested that such criminal fines are collected proceeds and that the award amount should be paid before the rest of the proceeds are transferred to the Victims of Crime Fund. As noted above, the Victims of Crime Act of 1984 mandates that the entire amount of fines imposed in criminal tax cases be deposited into the Victims of Crime Fund, meaning that the IRS lacks the authority to deposit only a portion of the fines into the Victims of Crime Fund, and these funds cannot be available to the Secretary to pay awards under section 7623. As a result, these regulations retain the rule from the proposed regulations, reflecting the determination that amounts deposited in the Victims of Crime Fund do not constitute collected proceeds. Criminal restitution, however, may be collected by the IRS as a tax under section 6201(a)(4)(A), and in such instances, the amounts collected as restitution are included in the definition of collected proceeds.

**Amended Returns**

The proposed regulations did not address whether amounts collected based on a taxpayer’s future compliance were included in collected proceeds. Commenters requested clarification on whether a whistleblower could receive an award based on amounts collected due to amended returns. Some commenters suggested that the definitions of administrative action or proceeds based on should be interpreted as providing for an award in cases when a taxpayer files an amended return in response to a whistleblower’s information. Similarly, these commenters suggested that the final regulations should encourage and reward whistleblowers who report internally and cause taxpayers to self-report to the IRS.

In the proposed regulations, Treasury and the IRS intended to include certain amounts collected based on amended returns as collected proceeds. The final regulations are modified to explicitly provide for this outcome. Section 7623(b) requires that the IRS proceed with an administrative or judicial action based on the information provided. Once the IRS proceeds with an action, however, the amounts collected based on amended returns may constitute collected proceeds. Specifically, if a whistleblower files a claim, the IRS begins an administrative or judicial action, and the taxpayer subsequently files an amended return, any proceeds collected based on that amended return, and related to the information provided, will constitute collected proceeds under the final regulations’ general definition of the term collected proceeds. But if the IRS does not proceed with an action, for example if a taxpayer files amended returns, preemptively self-assessing and paying the liability before the IRS initiates any action, then, consistent with the plain language of the statute, there can be no collected proceeds.

While Treasury and the IRS certainly encourage internal reporting and preemptive action to correct incorrect returns, the plain language of the statute does not provide for a determination of awards in such cases. Moreover, it would be nearly impossible for the Service to connect amended returns to internally-reported whistleblower claims. Ultimately, if the amounts paid based on amended returns can be linked to any action with which the IRS proceeded based on the whistleblower’s information, then the amounts will be included as collected proceeds. In such instances, the proceeds can be attributed to IRS action, as required by section 7623, and the proceeds collected may be determined by reference to the difference between the original amount reported as tax and the amount of tax assessed and collected based on the amended return. Treasury and the IRS believe that the changes to the final regulations reflect the statutory requirement that awards stem from IRS action and provide an administrable rule without discouraging whistleblowers from engaging in internal reporting and taxpayers to self-police.

The final regulations do not incorporate the comments suggesting that the IRS should also look to future years in which a taxpayer is compliant and determine collected proceeds in those years based on previous noncompliance. Unlike cases in which the taxpayer has already filed an original return, in these cases, the IRS would have no way to determine with any reasonable certainty what the taxpayer’s reporting position would have been if not for the underlying action and whether the taxpayer’s compliance was a direct result of the underlying action. Similarly, the IRS has no way of knowing whether a whistleblower’s internal reporting of an issue caused a taxpayer to self-report and pay taxes.

**Amount in Dispute**

Section 7623(b)(5) provides that subsection (b) applies only when the tax, penalties, interest, additions to tax, and additional amounts in dispute in an action against a taxpayer exceed $2,000,000 (and in the case of an individual taxpayer, when the individual’s gross income exceeds $200,000 for any taxable year subject to the action). The proposed regulations defined amount in dispute as the maximum total of tax, penalties, interest, additions to tax, and additional amounts that could have resulted from the action(s) with which the IRS proceeded based on the information provided, if the formal positions taken by the IRS had been sustained. The proposed regulations further provided that the IRS would compute the amount in dispute, for purposes of award determinations, after the final determination of tax. Finally, the proposed regulations provided that, for purposes of conducting whistleblower administrative proceedings, the IRS may rely on the
whistleblower’s description of the amount owed by the taxpayer(s) or other information. These rules were intended to ensure that administrative proceedings would be conducted for every claim that could arguably satisfy the requirements of section 7623(b)(5), even before the IRS knows whether the claim actually does.

Treasury and the IRS did not receive any comments recommending changes to the definition of amount in dispute. Nevertheless, Treasury and the IRS recognize the need to clarify an aspect of the definition that was not clear and that, without the clarification, could have led to unintended results. Specifically, the final regulations delete the reference to “could have resulted” so as not to suggest that a hypothetical computation is required. The final regulations further clarify that the amount in dispute is the greatest of the amounts actually determined and amounts stated in the formal positions actually taken by the IRS. Treasury and the IRS also added additional examples to further clarify the application of the rule adopted in the final regulations.

The definition will apply, regardless of whether an award is paid pursuant to section 7623(a) or section 7623(b), including for purposes of Tax Court review. For purposes of applying the administrative proceedings provided for under the final regulations, however, the Whistleblower Office may rely on the whistleblower’s description of the amount owed if that amount is higher than the maximum total amount asserted by the IRS in its formal position in an administrative or judicial action.

**Affiliated Claimants**

Under section 7623(b)(6)(C), no award may be made under section 7623(b) based on information submitted to the Secretary unless such information is submitted under penalty of perjury. In Notice 2008–4 and the proposed regulations, Treasury and the IRS provided that this requirement precludes the filing of a claim for award by a person serving as a representative of, or in any way on behalf of, another individual as part of implementing the statutory requirement that a claim for award be filed under penalties of perjury. Nonetheless, the proposed regulations provided a definition of affiliated whistleblowers and related rules for addressing eligible and ineligible affiliated whistleblower cases. Treasury and the IRS have reconsidered the need for the affiliated whistleblower rules in light of the statutory penalty of perjury requirement. Indeed, given that the final regulations retain the rule prohibiting a whistleblower from submitting a claim on behalf of another, the definition for affiliated individuals and the cross-reference to the rule for ineligible affiliated individuals at § 301.7623–1(b)(3) were removed from the final regulations. The rule for eligible affiliated whistleblowers at § 301.7623–4(c)(4) of the proposed regulations was also removed. The final regulations retain the rule, however, stating that the Whistleblower Office will reject claims filed by ineligible affiliated whistleblowers, to discourage and prevent whistleblowers from claiming an award in their own names based on information obtained from ineligible whistleblowers. In the final regulations, the rule is relocated and added to the list of ineligible whistleblowers.

**Whistleblower Administrative Proceedings—§ 301.7623–3**

Section 7623 does not require that the IRS conduct a particular administrative process prior to making an award determination, rejection, or denial. Treasury and the IRS, however, have determined that such processes will help ensure that whistleblowers have a meaningful opportunity to participate in the determination process, enable the Whistleblower Office to make award determinations based on complete information, and ensure a fully-documented record on appeal to the Tax Court. This regulation describes the administrative proceedings applicable to claims for award under both section 7623(a) and section 7623(b).

For purposes of applying the whistleblower administrative proceedings, the final regulations provide that the Whistleblower Office may rely on the whistleblower’s description of the amount owed or on other information. This rule is intended to ensure that the IRS can provide whistleblowers the benefits of proceedings applicable to section 7623(b) claims even before having made a final determination of tax.

For awards under section 7623(a), the proposed regulations provided that the Whistleblower Office will send a preliminary award recommendation letter to the whistleblower. Sending this letter marks the beginning of the whistleblower administrative proceeding. The whistleblower will then have 30 days within which to provide comments to the Whistleblower Office. This approach is intended to provide whistleblowers under section 7623(a) with an opportunity to participate in the award process, both to add transparency to the proceeding and to assist the Whistleblower Office in considering all potentially relevant information in paying awards under section 7623(a), even though those awards are not subject to Tax Court review. The proposed regulations did not, however, provide preliminary notice and comment procedures for rejections or denials of claims for award that are treated, for administrative purposes, as claims made under section 7623(a), given the large administrative burden associated with such procedures.

In cases in which the Whistleblower Office determines and pays an award under section 7623(b), the proposed regulations provided that a whistleblower administrative proceeding also begins when the Whistleblower Office sends out the preliminary award recommendation letter. After this letter is sent to the whistleblower, the whistleblower (and the whistleblower’s representative, if any) may participate in the administrative proceeding under section 7623(b), which will ultimately culminate in an award determination letter issued by the Whistleblower Office. Finally, the proposed regulations provided that prior to denying or rejecting a claim under section 7623(b), the Whistleblower Office will send a preliminary denial letter to the whistleblower, beginning the administrative proceeding and after which the whistleblower has 30 days to provide comments to the Whistleblower Office. Again, this approach is intended to foster a transparent and accurate review process.

The final regulations in large part adopt the proposed regulations. The comments received and any changes to the proposed
rules for § 301.7623–3 are discussed in the sections that follow.

Beginning of Whistleblower Administrative Proceedings

Under the proposed regulations, in cases in which the Whistleblower Office recommends payment of an award under section 7623(a) or determines and pays an award under section 7623(b), the Whistleblower Office will first send a preliminary award recommendation letter to the whistleblower. In these cases, the whistleblower administrative proceeding begins when this letter is sent. In cases in which the Whistleblower Office rejects or denies a claim for award under section 7623(b), the Whistleblower Office will first send a preliminary denial letter to the whistleblower. In these cases, the whistleblower administrative proceeding begins when this letter is sent. In cases in which the Whistleblower Office rejects or denies a claim for award under section 7623(a), there will not be a separate administrative proceeding. (For further information, see Rejections and Denials, later in this preamble.) The final regulations largely adopt the proposed regulations. The comments received and the changes made are discussed in further detail in this section.

Several commenters suggested that whistleblower administrative proceedings should begin earlier. The commenters offered different suggestions for how this could be accomplished, including beginning whistleblower administrative proceedings at the time that a claim is submitted on the Form 211 or when the Form 11369, “Confidential Evaluation Report on Claim for Award,” is transmitted to the Whistleblower Office by the Operating Division. One commenter suggested that the regulations should require the Whistleblower Office to notify the whistleblower and begin the administrative proceeding within 90 days of a taxpayer agreeing to pay any taxes, penalties, interest or additional amounts, and requesting that the whistleblower provide any information relevant to an award determination. The commenter suggested that these measures should be implemented to ensure that preliminary award determination letters are issued prior to a final determination of tax.

The proposed regulations provided for whistleblower administrative proceedings in an effort to respond to whistleblowers’ concerns regarding the IRS’s ability to communicate with whistleblowers. After considering the comments received, Treasury and the IRS determined that beginning the administrative proceeding before the preliminary award determination letter would not meaningfully increase a whistleblower’s ability to participate in and provide comments relating to the award determination. As discussed earlier in this preamble, the IRS will use several tools, including debriefings, section 6103(n) contracts, and section 6103(k)(6) disclosures to communicate with whistleblowers following the submission of a claim. The whistleblower award administrative proceedings discussed in this section of the preamble are intended to facilitate communication with whistleblowers before the IRS makes the award determination.

Deadlines for IRS Whistleblower Office Action

The proposed regulations provided no mandatory deadlines for Whistleblower Office action. The proposed regulations instead provided for payment of an award, when appropriate, as promptly as circumstances permit. Recognizing that the timely and comprehensive evaluation of information provided by whistleblowers is essential to the success of the program, the IRS has articulated goals for Whistleblower Office action in other internal guidance. IRS Whistleblower Program Memorandum (Deputy Commissioner for Services and Enforcement Steven T. Miller, June 20, 2012). This memorandum established goals for action on whistleblower submissions, and demonstrates the IRS’s commitment to timely and comprehensive evaluation of whistleblower information. The memorandum also recognizes the need for flexibility and recognizes that there are times when the established goals will not be met. This does not detract from the emphasis placed on timely action, but instead flows from a recognition of the unique nature of these claims and a desire to ensure that when the Whistleblower Office takes action, it has available all relevant and necessary information relating to an action.

The form comment letters suggested that the regulations should adopt and expand on the guidelines set out in the June 20, 2012, IRS Whistleblower Program Memorandum. Several commenters suggested that the final regulations should incorporate mandatory deadlines for action by the Whistleblower Office. Two commenters generally suggested that the regulations should require that preliminary award determination letters be sent by a specified time after proceeds are collected, for example, between 90 and 180 days after the IRS has collected proceeds. One commenter suggested that the regulations should require the Whistleblower Office to notify the whistleblower and begin the administrative proceeding within 90 days of a taxpayer agreeing to pay any taxes, penalties, interest or additional amounts, and requesting that the whistleblower provide any information relevant to an award determination within 30 days. This commenter suggested that the IRS should then send another notification to the whistleblower 90 days after the IRS had collected proceeds. This commenter suggested that these measures should be implemented to ensure that preliminary award determination letters are issued prior to a final determination of tax.

As noted, the June 20, 2012, IRS Whistleblower Program Memorandum identified timelines and policy goals for Whistleblower Office action. Treasury and the IRS have determined not to adopt these program goals as regulatory requirements to retain flexibility to make changes to accommodate future developments. The Whistleblower Office, however, remains committed to taking timely action on whistleblower submissions from the date a claim is first submitted through the date on which an award is determined or the claim is denied.

Deadlines for Whistleblower Action or Response

The proposed rules at § 301.7623–3 contained several deadlines for whistleblower action. These deadlines are designed to ensure that the administrative proceedings are conducted in a timely fashion. In cases in which the Whistle-
blower Office recommends payment of an award under section 7623(a), a whistleblower has 30 days to submit comments on the Whistleblower Office’s preliminary award determination. In cases in which the Whistleblower Office denies an award under section 7623(b), a whistleblower has 30 days to submit comments on the Whistleblower Office’s preliminary denial letter. Finally, in cases in which the Whistleblower Office determines an award under section 7623(b), the whistleblower has 30 days to respond to the preliminary award recommendation letter; when applicable, the whistleblower has 30 days to respond after receiving a detailed report from the Whistleblower Office; and when applicable, the whistleblower has 30 days to submit comments after receiving an opportunity to review the documents supporting the award report recommendations. Under the proposed regulations, the time periods for responding in cases in which the Whistleblower Office determines an award under section 7623(b) may be extended at the sole discretion of the Whistleblower Office.

Several commenters generally suggested that all of the time periods for whistleblowers to respond or submit comments should be more flexible. One commenter requested that different, longer time periods be applied to whistleblowers located outside of the United States. Another commenter suggested that “good cause” should be added as a reason why a whistleblower may take longer than 30 days to respond or submit comments to the Whistleblower Office. Finally, one commenter requested clarification on when the 30-day period to respond to the detailed report would begin.

After considering the comments, Treasury and the IRS adopt the proposed regulations without substantive change. The deadlines for whistleblower action in the final regulations are intended to allow whistleblower administrative proceedings to proceed in a timely and efficient manner. Further, the Whistleblower Office has the discretion to extend the time periods and has routinely done so at the request of whistleblowers or their representatives. In response to the comments, however, Treasury and the IRS included language in the final regulations intended to clarify that the periods begin when the Whistleblower Office sends the notices.

Award Consent Forms

A number of comments were received that expressed frustration with the amount of time that it takes from when a whistleblower submits a claim for award to when the Whistleblower Office pays the award. The factors that contribute to this length of time are largely outside of the control of whistleblowers and the Whistleblower Office. The proposed regulations, however, provided for award consent forms, which allow the Whistleblower Office to make an award determination and pay an award, without providing an award determination letter and waiting for the whistleblower’s time to appeal such determination to expire. The purpose of the award consent form is to expedite the administrative process for cases in which the whistleblower agrees with the Whistleblower Office’s preliminary award recommendation. A whistleblower may submit an award consent form to the Whistleblower Office at any time during the whistleblower administrative proceeding.

One commenter suggested that the award consent form is unfair because it forces the whistleblower to waive any appeal rights before receiving an award. Under the proposed rules, a whistleblower can receive an award regardless of whether an award consent form is submitted. For example, if a whistleblower declines to execute the award consent form, then after the whistleblower has finished participating in the whistleblower administrative proceeding and after a final determination of tax, the Whistleblower Office will provide the whistleblower with a determination letter, stating the amount of any award. In such cases, the award would be payable after all appeals of the Whistleblower Office’s determination were final. Executing the award consent and waiving the appeal rights serves to decrease the time between the determination and payment of the award. Because the execution of an award consent form is at the option of the whistleblower, these regulations retain the proposed regulations’ rules regarding the use of award consent forms. Under the final regulations, whistleblowers may choose to execute an award consent form at any time during the whistleblower’s participation in the administrative proceeding for award under section 7623(b). If the whistleblower signs, dates, and returns the award consent form, the Whistleblower Office will pay the award to the whistleblower as promptly as circumstances permit after there has been a final determination of tax. Thus, while there is absolutely no requirement that a whistleblower execute the award consent, doing so provides whistleblowers a way to get the benefit of finality and, assuming there are no other open issues, a faster award payment.

Confidentiality Agreements

Treasury and the IRS recognize that, while detailed administrative claim files assist the Whistleblower Office in making fair and accurate award determinations, safeguards aimed at preventing the potential redisclosure or misuse of the taxpayer’s confidential return information contained in those files remain critical. Section 6103(h)(4) and §301.6103(h)(4)–1 of the proposed regulations confirmed the authority to disclose return information in the course of a whistleblower administrative proceeding, but neither provides redisclosure prohibitions or penalties. In the Administration’s Fiscal Year 2014 and 2015 Revenue Proposals, Treasury recommended amending section 6103 to provide that the section 6103(p) safeguarding requirements apply to whistleblowers and their legal representatives who receive tax return information in whistleblower administrative proceedings. Despite the lack of statutory redisclosure prohibitions and penalties, Treasury and the IRS, in the proposed regulations, sought to balance whistleblowers’ desire for increased communication with protections and safeguards for taxpayers’ confidential information. Accordingly, the proposed regulations required whistleblowers to execute confidentiality agreements before they may receive a detailed description of the factors that contributed to the preliminary award recommendation or view documents that support the recommendation. A whistleblower is not required to execute a confidentiality agreement before appealing an award determination to the Tax Court, and
executing an agreement does not prevent a whistleblower from seeking Tax Court review.

One commenter recommended that every whistleblower should be required to enter into a confidentiality agreement with the Whistleblower Office at the time that they submit a claim. This commenter suggested that such agreements would allow the Whistleblower Office to share information with the whistleblower earlier in the process, prior to any whistleblower administrative proceeding. Another commenter also suggested that confidentiality agreements should be mandatory in every case to allow for the disclosure of information to whistleblowers and to provide protection to taxpayers with respect to disclosed information.

Although Treasury and the IRS support the use of confidentiality agreements as a mechanism for protecting confidential taxpayer return information disclosed during the course of an administrative proceeding, the agreements do not in themselves authorize the IRS or the Whistleblower Office to disclose such information. In addition, Treasury and the IRS have determined that disclosures are not necessary in every case. Accordingly, the final regulations do not mandate the use of confidentiality agreements in every case. Instead, the final regulations adopt the rule in the proposed regulations permitting whistleblowers to choose to enter into confidentiality agreements with the Whistleblower Office during whistleblower administrative proceedings for awards under section 7623(b). When the whistleblower signs, dates, and returns the confidentiality agreement, the Whistleblower Office will provide the whistleblower with a detailed award report and an opportunity to review documents supporting the detailed report. During this appointment, the Whistleblower Office will provide for viewing the pertinent information from the administrative claim file. The Whistleblower Office will supervise the whistleblower’s review of the documents and the whistleblower will not be permitted to make copies of the documents. Thus, while the proposed regulations provide whistleblowers with an opportunity to view information in the administrative claim file that is not protected from disclosure by one or more common law or statutory privileges, the proposed regulations provided rules intended to safeguard the disclosure of information to a whistleblower.

One commenter suggested that the whistleblower should be able to review all non-privileged information in the administrative claim file, whether or not it is deemed pertinent. Treasury and the IRS have determined that the rules applicable to the document review—including on site review and no copying—adequately protect taxpayer information from redisclosure. Accordingly, in response to this comment, the final regulations remove the term “pertinent.”

Administrative Record

Under the proposed regulations, the administrative record comprises all information contained in the administrative claim file that is not protected by one or more statutory privileges that is relevant to the award determination. One commenter suggested that the IRS Whistleblower Office should be required to provide a privilege log to detail any items that are excluded from the administrative record. After considering the comment, Treasury and the IRS have determined that creating a privilege log in every administrative proceeding involving privileged documents that are withheld by the Whistleblower Office would offer minimal benefits and pose an unjustifiable administrative burden. As a result, no changes were made to the proposed regulations.

Rejection and Denial Letters

The proposed regulations provided for rejection and denial letters in cases under section 7623(a) and 7623(b). In practice, a rejection is a determination that relates solely to the whistleblower and the information on the face of his or her claim that pertains to the whistleblower, while a denial often relates to or implicates taxpayer information (for example, because the IRS did not proceed based on the information provided or did not collect any proceeds). Pursuant to proposed § 301.7623–3(b)(3), for rejections or denials under section 7623(a), the Whistleblower Office will provide written notice to claimants of the rejection or denial of award claims without an administrative proceeding. One commenter expressed concern with the amount of information contained in rejection and denial letters. In these cases, because there is no whistleblower administrative proceeding, section 6103 (which provides that all tax return information is confidential, unless an exception applies) operates to limit the amount of taxpayer information that the Whistleblower Office can provide. Treasury and the IRS considered whether to make denials of claims under section 7623(a) subject to an administrative proceeding similar to the denial of claims under section 7623(b). However, given the nature of claims under section 7623(a) and the large number of such claims, Treasury and the IRS determined that the administrative burden of providing an administrative proceeding would significantly outweigh the small amount of additional information that would be provided in the denial letters. We note, however, that the same section 6103 concerns are not present with rejection letters. Accordingly, in the case of a rejection under section 7623(a) or (b), the written notice is not subject to the same limitations under section 6103 and will explain the basis for the rejection. Although no substantive changes were made, to improve clarity, the final regulations separate the rules for rejections under section 7623(b) and denials under section 7623(b) into separate provisions and describe when a claim is rejected or denied.

Subsequent Determinations

One commenter suggested that the definition of collected proceeds should take into account circumstances in which a whistleblower submits a claim for an on-
going issue and an administrative action is taken for some, but not all years (apparently because the statute of limitations has expired). If the taxpayer becomes compliant in future years, the commenter suggested that the whistleblower’s award should be determined based on collected proceeds for future years determined as the difference between what is reported and paid, and what would have been reported and paid, if not for the whistleblower’s information and the IRS’ administrative action. The commenter suggested limiting the future years to the number of years for which the IRS allowed the statute of limitations to expire with respect to the whistleblower claim. No changes were made to the proposed regulations because the commenter’s concern—that the IRS will not be diligent in preserving the statute of limitations—is ameliorated by the fact that the IRS suffers a greater harm than the whistleblower if the IRS permits the statute of limitations to expire and, therefore, the IRS is motivated to preserve the statute of limitations.

Another commenter suggested that the final regulations should include procedures for reopening a claim that was initially denied if the information is later used by the IRS, for example, by a different Operating Division. The proposed regulations did not provide specific procedures for addressing the use of a whistleblower’s information following a denial. However, nothing in the proposed regulations precluded future IRS action based on a whistleblower’s information or the determination of an award in such instances. For example, the proposed regulations did not preclude the Whistleblower Office from making a second or subsequent determination after a whistleblower’s information following a denial. However, nothing in the proposed regulations precluded future IRS action based on a whistleblower’s information or the determination of an award in such instances. For example, the proposed regulations did not preclude the Whistleblower Office from making a second or subsequent determination when the IRS proceeds based on the information after having already made a determination. This situation, however, is distinguishable from timing cases, discussed earlier in this preamble, in connection with the definition of collected proceeds, in which the IRS recomputes and pays an award based upon information not known with respect to the taxpayer’s account as of the date of the final determination of tax. These cases would include, for example, those in which whistleblower information results in the elimination of an NOL but does not result in collected proceeds until after the final determination. In such cases, there are no new circumstances, only additional collected proceeds. A second or subsequent determination, however, is appropriate when there are new circumstances that result in collected proceeds. Although this result was not precluded under the proposed regulations, Treasury and the IRS added language to the definition of final determination of tax at § 301.7623–4(d)(2) of the final regulations to explicitly clarify this point. Because the final regulations allow for subsequent determinations when proceeds are collected after an initial determination, and any such subsequent determination will be subject to all the rules and procedures applicable to an initial determination, no additional procedures are needed in these final regulations.

Determining the Amount of Awards and Paying Awards—§ 301.7623–4

This regulation provides the framework and criteria that the Whistleblower Office will use in exercising the discretion granted under section 7623 to make awards. Under the regulation, based on the Whistleblower Office’s review of the entire administrative claim file, the Whistleblower Office will assign a fixed percentage to claims for award by evaluating the substantial contribution of the whistleblower to the underlying action(s). The rules of this section apply to claims for awards under both section 7623(a) and section 7623(b). The comments received and any changes to proposed § 301.7623–4 are discussed in the sections that follow.

Fixed Percentage Computational Framework

Under section 7623(b), whistleblowers may receive as an award at least 15 percent but not more than 30 percent of the collected proceeds resulting from an action (including any related actions), assuming that there is no reduction in award pursuant to section 7623(b)(2) or (3). The proposed regulations adopted a fixed percentage approach pursuant to which the Whistleblower Office will assign claims for award to one of a number of fixed percentages within the applicable award percentage range. Under the proposed regulations, to compute an award, the Whistleblower Office will look to the administrative claim file to determine whether there are any positive factors present that would merit an increased award of 22 or 30 percent. The Whistleblower Office will then determine whether there are negative factors present that would merit a decreased award of 15, 18, 22, or 26 percent.

One commenter disagreed with the use of fixed percentages, suggesting that instead the Whistleblower Office should have the discretion and flexibility to consider the full range of award percentages in reaching an award determination. A number of the comments received, including the form comment letters, suggested that starting the award computation framework at 15 percent sends the wrong message to whistleblowers and would discourage whistleblowers by limiting the size of whistleblower awards. One commenter suggested that starting at 15 percent was unnecessarily biased toward the lower end of the statutorily mandated range of 15 to 30 percent. This commenter suggested that this approach would invite litigation and would limit the upward effect of positive factors. Instead, this commenter recommended that the Whistleblower Office should begin its analysis at 22.5 percent. Another commenter suggested that starting at the bottom prevents the Whistleblower Office from punishing whistleblowers that have only negative factors and also suggested that the Whistleblower Office should begin its analysis at 22.5 percent. One commenter suggested that the regulations should also require payment of a minimum 15-percent award both when a taxpayer self-reports a tax liability after a whistleblower submits information to the IRS and when a whistleblower provides information and the IRS subsequently proceeds with an administrative action without using the whistleblower’s information. Finally, several commenters requested that the final regulations provide additional information on when a 30-percent award would be appropriate under the statute. These commenters suggested that the regulations should provide an example of a case in which the Whistleblower Office would determine a 30-percent award. To that
Treasury and the IRS continue to believe that the fixed percentage approach provides a structure that will promote consistency in the award determination process by enabling the Whistleblower Office to determine awards across the breadth of the applicable percentage range based on meaningful distinctions among cases. The fixed percentage approach also avoids having to draw fine distinctions that might seem unfair and arbitrary, given the differences among claims for award with respect to both the facts and law of the underlying actions and the nature and extent of the substantial contribution of the whistleblowers. Accordingly, the final regulations retain the fixed percentage approach.

Further, Treasury and the IRS determined that starting the award determination at 15 percent merely reflects the fact that the claim has met the threshold requirements for an award under section 7623(b). All awards under section 7623(b)(1) are paid to whistleblowers that made a substantial contribution to the underlying action(s). Congress, through the plain language of the statute, provided that a 15-percent award is appropriate for a whistleblower that makes a substantial contribution to the underlying action(s). Congress, therefore, established a minimum award that incentivizes whistleblowers to provide high quality submissions that reflect positive factors.

Moreover, the approach taken in the final regulations—starting at 15 percent and applying positive and negative factors, based on the extent of the whistleblower’s substantial contribution—is consistent with the approach taken by other government agencies in the regulations and practices that govern the administration of their whistleblower award programs, including the Department of Justice (in making recommendations in False Claims Act cases), the Securities and Exchange Commission, and Commodity Futures Trading Commission (in applying Federal whistleblower statutes). As it has done since the 2006 amendments to the statute, the Whistleblower Office will increase the award percentage, based on the presence of positive factors. The final regulations provide several positive factors designed to allow for increased awards across a broad range of claims, as merits.

Moreover, the concern expressed by some commenters that the IRS will pay minimum awards in most cases is not supported by the evidence. To date, using this computational approach the IRS has paid awards totaling approximately $175 million on collected proceeds totaling approximately $700 million, reflecting an award average of approximately 25 percent—nearer the top than the bottom of the statutory range. After considering the concerns raised by these comments, the final regulations retain the fixed percentage approach adopted in the proposed regulations. Finally, in response to the comments received on 30-percent awards, Treasury and the IRS revised the example, extending it to illustrate the full award percentage range.

Factors Used to Determine Award Percentage

Pursuant to section 7623(b), the Whistleblower Office’s determination of an award amount depends on the extent to which the claimant’s information substantively contributed to the underlying action(s). Under the proposed regulations, the Whistleblower Office reviews the administrative claim file and applies the positive factors and negative factors, listed in § 301.7623–4(b), to the facts to determine the fixed percentage applicable to a claim for award.

Some commenters offered suggestions for additional positive factors. These suggestions included: i) the whistleblower provides information on multiple unrelated taxpayers; ii) the whistleblower identifies the target taxpayer; iii) the whistleblower provides information that leads to a related party; iv) the IRS would not have discovered a violation “but for” the whistleblower’s information; and v) there is a close nexus between related actions. Some of these suggested factors are already threshold elements required to merit any award. For example, identifying the target taxpayer is required to make a claim. Others restate the circumstances for which the proposed regulations already compensated whistleblowers. For example, if a whistleblower provides information on multiple unrelated taxpayers or uncovering a close nexus between related actions, and the IRS proceeds based on the information and collects proceeds, then the whistleblower’s contribution to each action will be evaluated and accounted for in determining the award. Further, the final regulations, like the proposed regulations, provide that the positive factors and negative factors are non-exclusive. Accordingly, the final regulations do not incorporate any of these suggested factors. The Whistleblower Office may recognize and apply additional factors in a particular case that are appropriate in light of the particular facts.

One commenter suggested that the positive factor at § 301.7623–4(b)(1)(ii), regarding information that identifies an is-
not to incorporate any new negative or mitigating factors into the final regulations, which would serve only to make it harder for whistleblowers to recover. The Whistleblower Office will consider all of the relevant facts and circumstances when looking to apply the positive and negative factors identified in the regulations.

One commenter suggested that the negative factor when the whistleblower contributed to the underpayment of tax or tax noncompliance identified is already addressed by the planned and initiated test. The inclusion of this factor signifies that not all situations when a whistleblower contributes to the actions that led to the underpayment will constitute planning and initiating under the statute and regulations—as discussed later in this preamble, the threshold for planned and initiated is higher than being a mere contributor. In cases when a whistleblower does not plan and initiate within the meaning of the statute and regulations—as discussed later in this preamble, the threshold for planned and initiated is higher than being a mere contributor. In cases when a whistleblower does not plan and initiate within the meaning of the statute and regulations, the Whistleblower Office will not apply the threshold planner and initiator test, but in such a case, it may still be appropriate to decrease the award amount because the whistleblower’s actions diminish the extent of the whistleblower’s substantial contribution to the action. Thus, the Whistleblower Office will instead consider the whistleblower’s contribution to the tax noncompliance as a factor that may justify a decrease within the 15-to-30 percent award percentage range. For example, this factor may apply if a whistleblower engaged in planning or initiating activities, but not both, that diminished the whistleblower’s substantial contribution to the action with which the IRS proceeded. This factor will not, however, be applied to reduce an award in cases in which the Whistleblower Office determines that the threshold for planned and initiated has been met. If the threshold for planned and initiated is met, the planned and initiated framework will be applied, and the final regulations have been clarified accordingly.

Award for Less Substantial Contribution

Section 7623(b)(2) provides for a reduced award when the Whistleblower Office determines that the action was based primarily on disclosures of specific allegations resulting from a judicial or administrative hearing, a governmental report, hearing, audit, or investigation, or the news media, unless the whistleblower was the original source of the information. Under the proposed regulations, if the Whistleblower Office determined that an action was based principally on disclosures of specific allegations resulting from public source information then the Whistleblower Office will determine an award of no more than 10 percent of the collected proceeds resulting from the action, unless the whistleblower was the original source of the information. The proposed regulations provided that the Whistleblower Office would make the determination based on the extent to which the public source information described a tax violation or facts and circumstances from which a tax violation could be reasonably inferred. Under the proposed regulations, public source information included a judicial or administrative hearing, a government report, hearing, audit, or investigation, or the news media.

Treasury and the IRS received two comments on this proposed rule. One commenter suggested that public source information should be limited to the types of information specified in the statute. This commenter disagreed with the proposed regulations’ use of the word “including” and expressed concern that this language would allow the Whistleblower Office to expand on the statutory list of public sources. This commenter also suggested that the regulations should exclude public source information that is only available by request. Another commenter disagreed with the application of the original source test in the proposed regulations. This commenter suggested that rather than looking to whether the whistleblower was the original source of the public source information, the regulations should instead look to whether the IRS takes action based on the information provided, and if so, should treat the whistleblower as the original source of the information. Both commenters expressed concern that the proposed regulations did not accurately apply the specific allegation requirement from the statute, and one of the two commenters further suggested that the regulations should employ an ordinary, lay person standard if a “reason-
were tax implications to planning and initiating the underlying act, was too broad. One of these commenters suggested that instead, the threshold should be whether the whistleblower knew or had reason to know that tax noncompliance could result from the planning and initiating of the underlying act. Similarly, one commenter suggested that the standard should be whether the individual knew or had reason to know that there were “unlawful” or “improper” tax implications. Some commenters suggested that the language at § 301.7623–4(c)(3)(ii)(C) should specifically exclude a whistleblower who performed any of the underlying activities at the direction of a senior employee or manager. One commenter suggested that including the word “drafted” in the definition of “planned” created the possibility that an employee drafting a document at the direction of superiors could fall within the definition. This commenter also suggested that including the term “promoted” in the definition of “initiated” could include someone involved well after the scheme was actually initiated. One commenter suggested that the primary, significant, or moderate categories are not supported by the statute, and risk being implemented in a way that a whistleblower can be something other than a principal architect. Finally, two commenters offered suggestions for the examples in the proposed regulations. The comments on the examples focused on the application of the planned and initiated standard rather than on the application of the computational framework. One comment specifically suggested that the examples should provide guidance about what it means to plan and initiate, rather than guidance on the application of the computational framework.

The final regulations do not adopt a “principal architect” approach to the application of section 7623(b)(3), based in part on the statutory language, which does not require a single planner and initiator but instead provides for the possibility of multiple planners and initiators. More than one individual may plan and initiate the actions that lead to a tax underpayment or violation, whether as co-planners or as planners of independent actions that each led to the underpayment or violation. However, the terms “plan” and “initiate” suggest some voluntary action on the part of the individual. Thus, where an individual is acting under the direction and control of a supervisor, he or she should not be considered as planning or initiating. For example, the planned and initiated standard is not intended to apply to a junior associate acting under the direction of a partner. Nonetheless, the application of these rules is dependent on the relevant facts and circumstances of each case and, at some point, an associate or other employee becomes experienced enough to act sufficiently on his or her own to be considered a planner and initiator. The final regulations modify the examples to clarify the treatment of junior employees.

Reduction in Award and Denial of Award

Under the proposed regulations, the Whistleblower Office will make a threshold determination of whether a whistleblower planned and initiated the underlying acts, and, if this threshold is met, then the Whistleblower Office will categorize and evaluate the extent of the whistleblower’s planning and initiating of the underlying acts, based on the application of factors listed in § 301.7623–4(c)(3)(iv) to the facts contained in the administrative claim file, to determine the amount of the appropriate reduction, if any.

Commenters on this issue generally expressed concern that the threshold determination for planned and initiated is too broad and could discourage potential whistleblowers from coming forward. These commenters suggested that the regulations should adopt the “principal architect” approach used in evaluating claims under the False Claims Act. Two of the commenters expressed concern that the standard at § 301.7623–4(c)(3)(ii)(C), which asked whether the whistleblower knew or had reason to know that there were tax implications to planning and initiating the underlying act, was too broad.

In response to the first commenter’s concerns, the final regulations remove the term “public source information” and the “including” language and instead rely solely on the list of statutory sources. In determining that the final regulations should rely solely on the statutory list, Treasury and the IRS also decline to place additional limitations on the statutory language, for example, excluding information available only upon request. The final regulations also clarify the application of the original source test and the specific allegation requirement by more clearly tracking the language of the statute. The final regulations clarify that the reasonable inference test does not replace the specific allegation requirement, but instead provides guidance on how the Whistleblower Office will apply the statute’s specific allegation requirement. Changes were also made to the example to illustrate the operation of the reasonable inference test.

Changes were also made to the example to illustrate the operation of the reasonable inference test.
the plain language of the statute by providing for a sliding scale of reductions to an award for planning and initiating.

**Eligible Affiliated Whistleblowers**

As discussed earlier in this preamble, Treasury and the IRS decided not to incorporate the proposed rule for eligible affiliated whistleblowers at § 301.7623–4(c)(4) in the final regulations because it is inconsistent with the rule that prohibits a whistleblower from submitting a claim on behalf of another individual.

**Multiple Whistleblowers**

Section 7623 does not address whether multiple whistleblowers may receive an award from the same collected proceeds. The proposed regulations provided rules for determining awards when two or more independent claims, based on different information, relate to the same collected proceeds. In these situations, the proposed regulations allowed the Whistleblower Office to determine multiple awards, limited in aggregate amount to the maximum amount that could have been awarded to a single whistleblower, rather than restricting the determination to a single award payable to the first whistleblower that files a claim for award or payable on some other basis.

Treasury and the IRS received two comments on this issue. One commenter suggested that multiple whistleblowers should not have to share an award. The other commenter suggested that the first whistleblower should receive full credit for their information and that later whistleblowers should only receive an award for information that was not provided by the first whistleblower. After consideration of the comments, Treasury and the IRS determined to leave open the possibility of award payments for multiple whistleblowers. This determination was based in part on the recognition that the tax administration process is a long and multi-faceted one that may extend over the course of many years and may involve multiple substantial contributions from different sources. Given the unique nature of the tax administration process, Treasury and the IRS determined that it would not be fair or appropriate to determine an award only for the substantial contribution of whistleblowers who submit their information first-in-time. Accordingly, the proposed regulations are adopted without change.

**Payment of Awards**

Section 7623 provides for payment of an award to the individual that submits information and makes a claim for award. Under the proposed regulation, the IRS will pay any award under section 7623 to a whistleblower as promptly as circumstances permit after there has been a final determination of tax with respect to the action(s) and after the Whistleblower Office has determined the award and all appeals of the determination are final or the whistleblower has executed an award consent form.

Treasury and the IRS received two comments on this proposed rule. One commenter suggested that the final regulations should provide procedures for payment of an award to attorney trust accounts. Another commenter suggested that whistleblowers should be allowed to assign or sell their claim for award. The issues raised in these comments are beyond the scope of the current regulations and, accordingly, the regulations have been finalized as proposed.

**Final Determination of Tax**

Under the proposed regulations, the Whistleblower Office can only pay an award determined pursuant to section 7623 after there is a final determination of tax. A final determination of tax may be made after the proceeds resulting from the action(s) subject to the award determination have been collected and either the statutory period for filing a claim for refund has expired or the taxpayer(s) subject to the action(s) and the IRS have agreed with finality to the tax or other liabilities for the period(s) at issue and the taxpayer(s) have waived the right to file a claim for refund. This general rule already includes the commenter’s suggestion that, in many cases, a final determination may occur when the IRS and the taxpayer enter into a closing agreement and the taxpayer makes full payment of the liability. As a result, the regulations were not revised in light of this comment. Recognizing that some claims result in more than one action, the definition pro-
vides the Whistleblower Office with the discretion to aggregate or disaggregate actions arising out of a single claim, meaning that the Whistleblower Office can, in appropriate cases, make more than one final determination with respect to a single claim for an award. For example, the Whistleblower Office generally will aggregate two actions, for award determination purposes, when the outcome of one will have an effect on the amount of collected proceeds that will result from the other. As discussed earlier in this preamble, the final regulations include new language that explicitly allows for subsequent determinations when the IRS proceeds based on the information provided after having already paid, rejected, or denied an award. This rule is illustrated through the addition of a new example.

As noted, Treasury and the IRS declined, however, to provide for mandatory, partial or ongoing payments of awards in the final regulations, based on the determination that issuing multiple appealable final determinations as a rule would impose an unreasonable burden on the IRS and the Whistleblower Office. Accordingly, the final regulations’ explicit statement that a final determination of tax does not preclude a subsequent final determination of tax is not intended to, and does not in any way, limit the discretion of the Whistleblower Office to aggregate or disaggregate actions for purposes of determining awards. The Whistleblower Office will continue to consider numerous factors relating to efficient tax administration in exercising this discretion, including the factors that it has previously identified in instructions to staff, instructions which are available via the IRS’s website and that will be incorporated into the IRM when it is next updated.

**Deceased Whistleblowers**

Existing Treas. Reg. § 301.7623–1(b)(3) allows an executor, administrator, or other legal representative to file a claim for award for a deceased whistleblower, if evidence is provided to show that the representative has legal authority to act on behalf of the deceased. The proposed regulations provided that when a whistleblower dies before or during a whistleblower administrative proceeding, the Whistleblower Office will substitute an executor, administrator, or other legal representative on behalf of the deceased whistleblower for purposes of conducting the whistleblower administrative proceeding. No comments were received on this provision. Because the proposed regulations’ use of the word “will” could be read to suggest that the regulations require substitution, Treasury and the IRS changed this word to “may” in the final regulations. Consistent with the regulations in effect under section 7623 at the time of the 2006 amendments to the statute, the Whistleblower Office will substitute such parties for a deceased whistleblower only when a party can make a proper showing that he or she is legally authorized to act for the deceased. The Whistleblower Office has no obligation to locate or determine a substitute for a deceased whistleblower. Accordingly, the final regulations provide that when a whistleblower dies before or during a whistleblower administrative proceeding, the Whistleblower Office may substitute an executor, administrator, or other legal representative on behalf of the deceased whistleblower for purposes of conducting the whistleblower administrative proceeding.

**Tax Treatment of Awards**

Under the proposed regulations, all awards are subject to current Federal tax reporting and withholding requirements. No comments were received on this provision. Treasury and the IRS, however, added language to the final regulations to clarify that whistleblower awards are includible in gross income.

**Effective/Applicability Dates**

Sections 301.7623–1, 301.7623–2, 301.7623–3, and 301.6103(h)(4)–1 were proposed to apply to information submitted on or after the date the rules are adopted as final regulations in the Federal Register, and to claims for award under sections 7623(a) and 7623(b) that are open as of that date. Likewise, § 301.7623–4 was proposed to apply to information submitted on or after the date the rules are adopted as final regulations, and to claims for award under section 7623(b) that are open as of that date. Section 301.7623–4 was not proposed to apply to claims for award under section 7623(a) that are open as of that date.

Treasury and the IRS received two comments on the proposed effective dates. One commenter suggested that the proposed rules at § 301.7623–2 affect substantive rights of whistleblowers and should only be applicable to claims filed after the adoption of the final regulations. The other commenter similarly suggested that the regulations should be prospective and apply only to submissions made after the regulations have been finalized.

The final regulations do not negatively affect substantive rights of whistleblowers because the proposed and final regulations largely incorporate existing practices adhered to by the Whistleblower Office, and changes from existing practices are designed to be favorable to whistleblowers. For example, the regulations provide for whistleblower administrative proceedings, but as discussed earlier in this preamble, these proceedings are intended to benefit whistleblowers, providing them with additional due process and opportunities to participate in a whistleblower award determination. Finally, applying two sets of rules to whistleblower proceedings will be difficult for the Whistleblower Office to administer. The effective dates for the regulations will allow the Whistleblower Office to administer the Whistleblower Program in an efficient manner. Accordingly, after considering the comments, Treasury and the IRS adopt the proposed regulations without changes.

**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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. It is hereby certified that these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that these regulations will primarily affect individuals who file whistleblower claims under section 7623. Accordingly, a regulatory flexibility analysis
under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business, and no comments were received.

Drafting Information

The principal author of these regulations is Melissa A. Jarboe of the Office of the Associate Chief Counsel (Procedure and Administration).

Adoption of Amendment to the Regulations

Accordingly, 26 CFR part 301 is amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

Paragraph 1. The authority citation for part 301 is amended by removing the entry for § 301.7623–1 and adding entries in numerical order for §§ 301.6103(h)(4)–1 and 301.7623–1 through 301.7623–4 to read as follows:


§ 301.6103(h)(4)–1 also issued under 26 U.S.C. 6103(h)(4) and 26 U.S.C. 6103(q).

§ 301.7623–1 through 301.7623–4 also issued under 26 U.S.C. 7623.

Par. 2. Section 301.6103(h)(4)–1 is added to read as follows:

§ 301.6103(h)(4)–1 Disclosure of returns and return information in whistleblower administrative proceedings.

(a) In general. A whistleblower administrative proceeding (as described in § 301.7623–3) is an administrative proceeding pertaining to tax administration within the meaning of section 6103(h)(4).

(b) Disclosures in whistleblower administrative proceedings. Pursuant to section 6103(h)(4) and paragraph (a) of this section, the Director, officers, and employees of the Whistleblower Office may disclose returns and return information (as defined by section 6103(b)) to a whistleblower (or the whistleblower’s legal representative, if any) to the extent necessary to conduct a whistleblower administrative proceeding (as described in § 301.7623–3), including but not limited to—

(1) By communicating a preliminary award recommendation or preliminary denial letter to the whistleblower;

(2) By providing the whistleblower with an award report package;

(3) By conducting a meeting with the whistleblower to review documents supporting the preliminary award recommendation; and

(4) By sending an award decision letter, award determination letter, or award denial letter to the whistleblower.

(c) Effective/applicability date. This rule is effective on August 12, 2014. This rule applies to information submitted on or after August 12, 2014, and to claims for award under sections 7623(a) and 7623(b) that are open as of August 12, 2014.

Par. 3. Section 301.7623–1 is revised to read as follows:

§ 301.7623–1 General rules, submitting information on underpayments of tax or violations of the internal revenue laws, and filing claims for award.

(i) In general. In cases in which awards are not otherwise provided for by law, the Whistleblower Office may pay an award under section 7623(a), in a suitable amount, for information necessary for detecting underpayments of tax or detecting and bringing to trial and punishment persons guilty of violating the internal revenue laws or conniving at the same. In cases that satisfy the requirements of section 7623(b)(5) and (b)(6) and in which the Internal Revenue Service (IRS) proceeds with an administrative or judicial action based on information provided by an individual, the Whistleblower Office must determine and pay an award under section 7623(b)(1), (2), or (3). The awards provided for by section 7623 and this paragraph must be paid from collected proceeds, as defined in § 301.7623–2(d).

(ii) Eligibility to file claim for award. (1) In general. Any individual, other than an individual described in paragraph (b)(2) of this section, is eligible to file a claim for award and to receive an award under section 7623 and §§ 301.7623–1 through 301.7623–4.

(2) Ineligible whistleblowers. The Whistleblower Office will reject any claim for award filed by an ineligible whistleblower and will provide written notice of the rejection to the whistleblower. The following individuals are not eligible to file a claim for award or receive an award under section 7623 and §§ 301.7623–1 through 301.7623–4—

(i) An individual who is an employee of the Department of Treasury or was an employee of the Department of Treasury when the individual obtained the information on which the claim is based;

(ii) An individual who obtained the information through the individual’s official duties as an employee of the Federal Government, or who is acting within the scope of those official duties as an employee of the Federal Government;

(iii) An individual who is or was required by Federal law or regulation to disclose the information or who is or was precluded by Federal law or regulation from disclosing the information;

(iv) An individual who obtained or had access to the information based on a contract with the Federal Government; or

(v) An individual who filed a claim for award based on information obtained from an ineligible whistleblower for the purpose of avoiding the rejection of the claim that would have resulted if the claim was filed by the ineligible whistleblower.

(c) Submission of information and claims for award. (1) Submitting information. To be eligible to receive an award under section 7623 and §§ 301.7623–1 through 301.7623–4, a whistleblower must submit to the IRS specific and credible information that the whistleblower believes will lead to collected proceeds from one or more persons whom the whistleblower believes have failed to comply with the internal revenue laws. In general, a whistleblower’s submission should identify the person(s) believed to have failed to comply with the internal revenue laws and should provide substantive information, including all available documentation, that supports the whistleblower’s allegations. Information that
identifies a pass-through entity will be considered to also identify all persons with a direct or indirect interest in the entity. Information that identifies a member of a firm who promoted another identified person’s participation in a transaction described and documented in the information provided will be considered to also identify the firm and all other members of the firm. Submissions that provide speculative information or that do not provide specific and credible information regarding tax underpayments or violations of internal revenue laws do not provide a basis for an award. If documents or supporting evidence are known to the whistleblower but are not in the whistleblower’s control, then the whistleblower should describe the documents or supporting evidence and identify their location to the best of the whistleblower’s ability. If all available information known to the whistleblower is not provided to the IRS by the whistleblower, then the whistleblower bears the risk that this information might not be considered by the Whistleblower Office for purposes of an award.

(2) Filing claim for award. To claim an award under section 7623 and §§ 301.7623–1 through 301.7623–4 for information provided to the IRS, a whistleblower must file a formal claim for award by completing and sending Form 211, “Application for Award for Original Information,” to the Internal Revenue Service, Whistleblower Office, at the address provided on the form, or by complying with other claim filing procedures as may be prescribed by the IRS in other published guidance. The Form 211 should be completed in its entirety and should include the following information—

(i) The date of the claim;
(ii) The whistleblower’s name;
(iii) The whistleblower’s address and telephone number;
(iv) The whistleblower’s date of birth;
(v) The whistleblower’s taxpayer identification number; and
(vi) An explanation of how the information on which the claim is based came to the attention and into the possession of the whistleblower, including, as available, the date(s) on which the whistleblower acquired the information and a complete description of the whistleblower’s present or former relationship (if any) to person(s) identified on the Form 211.

(3) Under penalty of perjury. No award may be made under section 7623(b) unless the information on which the award is based is submitted to the IRS under penalty of perjury. All claims for award under section 7623 and §§ 301.7623–1 through 301.7623–4 must be accompanied by an original signed declaration under penalty of perjury, as follows: “I declare under penalty of perjury that I have examined this application, my accompanying statement, and supporting documentation and aver that such application is true, correct, and complete, to the best of my knowledge.” This requirement precludes the filing of a claim for award by a person serving as a representative of, or in any way on behalf of, another individual. Claims filed by more than one whistleblower (joint claims) must be signed by each individual whistleblower under penalty of perjury.

(4) Perfecting claim for award. If a whistleblower files a claim for award that does not include information described under paragraph (c)(2) of this section, does not contain specific and credible information as described in paragraph (c)(1) of this section, or is based on information that was not submitted under penalty of perjury as required by paragraph (c)(3) of this section, the Whistleblower Office may reject the claim or notify the whistleblower of the deficiencies and provide the whistleblower an opportunity to perfect the claim for award. If a whistleblower does not perfect the claim for award within the time period specified by the Whistleblower Office, then the Whistleblower Office may reject the claim. If the Whistleblower Office rejects a claim, then the Whistleblower Office will provide notice of the rejection to the whistleblower pursuant to the rules of § 301.7623–3(b)(3) or (c)(7). If the Whistleblower Office rejects a claim for the reasons described in this paragraph, then the whistleblower may perfect and resubmit the claim.

(d) Request for assistance. (1) In general. The Whistleblower Office, the IRS, or IRS Office of Chief Counsel may request the assistance of a whistleblower or the whistleblower’s legal representative. Any assistance shall be at the direction and control of the Whistleblower Office, the IRS, or the IRS Office of Chief Counsel assigned to the matter. See § 301.6103(n)–2 for rules regarding written contracts among the IRS, whistleblowers, and legal representatives of whistleblowers.

(2) No agency relationship. Submitting information, filing a claim for award, or responding to a request for assistance does not create an agency relationship between a whistleblower and the Federal Government, nor does a whistleblower or the whistleblower’s legal representative act in any way on behalf of the Federal Government.

(e) Confidentiality of whistleblowers. Under the informant’s privilege, the IRS will use its best efforts to protect the identity of whistleblowers. In some circumstances, the IRS may need to reveal a whistleblower’s identity, for example, when it is determined that it is in the best interests of the Government to use a whistleblower as a witness in a judicial proceeding. In those circumstances, the IRS will make every effort to notify the whistleblower before revealing the whistleblower’s identity.

(f) Effective/applicability date. This rule is effective on August 12, 2014. This rule applies to information submitted on or after August 12, 2014, and to claims for award under sections 7623(a) and 7623(b) that are open as of August 12, 2014.

Par. 4. Section 301.7623–2 is added to read as follows:

§ 301.7623–2 Definitions.

(a) Action. (1) In general. For purposes of section 7623(b) and §§ 301.7623–1 through 301.7623–4, the term action means an administrative or judicial action.

(2) Administrative action. For purposes of section 7623(b) and §§ 301.7623–1 through 301.7623–4, the term administrative action means all or a portion of an Internal Revenue Service (IRS) civil or criminal proceeding against any person that may result in collected proceeds, as defined in paragraph (d) of this section, including, for example, an examination, a collection proceeding, a status determination proceeding, or a criminal investigation.
(3) Judicial action. For purposes of section 7623(b) and §§ 301.7623–1 through 301.7623–4, the term judicial action means all or a portion of a proceeding against any person in any court that may result in collected proceeds, as defined in paragraph (d) of this section.

(b) Proceeds based on. (1) In general. For purposes of section 7623(b) and §§ 301.7623–1 through 301.7623–4, the IRS proceeds based on information provided by a whistleblower when the information provided substantially contributes to an action against a person identified by the whistleblower. For example, the IRS proceeds based on the information provided when the IRS initiates a new action, expands the scope of an ongoing action, or continues to pursue an ongoing action, that the IRS would not have initiated, expanded the scope of, or continued to pursue, but for the information provided. The IRS does not proceed based on information when the IRS analyzes the information already in the Exam team's possession. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the IRS's examination is not an administrative action with which the IRS proceeds based on information provided by the whistleblower because the information provided substantially contributed to the action by causing the expansion of the IRS’s examination of Year 1 and Year 2. The portions of the IRS’s examination of the taxpayer in both Year 1 and Year 2 relating to the additional facts obtained through the issuance of IDRs and summonses are not actions with which the IRS proceeds based on the information provided by the whistleblower because the information provided did not substantially contribute to the action.

Example 3. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1–identifies a taxpayer, describes and documents specific facts relating to the taxpayer’s foreign sales in Country A, and, based on those facts, alleges that the taxpayer was not entitled to a foreign tax credit relating to its foreign sales in Country A. The IRS receives the information after having already initiated an examination of the taxpayer. The IRS’s audit plan includes foreign tax credit issues but focuses on taxpayer’s foreign sales in Country B and does not specifically address the taxpayer’s foreign sales in Country A. Based on the information provided, the IRS expands the examination of the foreign tax credit issue to include consideration of the amount of foreign tax credit relating to the taxpayer’s foreign sales in Country A. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the portion of the IRS’s examination of the taxpayer relating to the foreign tax credit issue with respect to Country A is an administrative action with which the IRS proceeds based on the information provided by the whistleblower because the information provided substantially contributed to the action by causing the expansion of the IRS’s examination.

Example 1. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1–identifies a taxpayer, describes and documents specific facts relating to the taxpayer’s activities of Taxpayer 1 that the whistleblower allegations tax underpayments by Taxpayer 1. The IRS proceeds with an examination of Taxpayer 1 based on the information provided by the whistleblower. The IRS discovers that the taxpayer engaged in the same activities in Year 2 and expands the examination to Year 2. In the course of the examination, the IRS obtains, through the issuance of Information Document Requests (IDRs) and summonses, additional facts that are unrelated to the activities described in the information provided by the whistleblower. Based on these additional facts, the IRS expands the scope of the examination of the taxpayer for both Year 1 and Year 2. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the portion of the IRS’s examination relating to the activities described and documented in the information provided is an administrative action with which the IRS proceeds based on information provided by the whistleblower because the information provided substantially contributed to the action by causing the expansion of the IRS’s examination of Year 1 and Year 2. The IRS proceeds with the action against the other person based on the specific facts described and documented in the information provided; and

(iii) The other, unidentified person is related to the person identified in the information provided. For purposes of this paragraph, an unidentified person is related to the person identified in the information provided if the IRS can identify the unidentified person using the information provided (without first having to use the information provided to identify any other person or having to independently obtain additional information).

(2) Examples. The provisions of paragraph (b)(1) of this section may be illustrated by the following examples:

Example 1. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1–identifies a taxpayer, describes and documents specific facts relating to the taxpayer’s foreign sales in Country A, and, based on those facts, alleges that the taxpayer was not entitled to a foreign tax credit relating to its foreign sales in Country A. The IRS receives the information after having already initiated an examination of the taxpayer. The IRS’s audit plan includes foreign tax credit issues but focuses on taxpayer’s foreign sales in Country B and does not specifically address the taxpayer’s foreign sales in Country A. Based on the information provided, the IRS expands the examination of the foreign tax credit issue to include consideration of the amount of foreign tax credit relating to the taxpayer’s foreign sales in Country A. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the portion of the IRS’s examination of the taxpayer relating to the foreign tax credit issue with respect to Country A is an administrative action with which the IRS proceeds based on the information provided by the whistleblower because the information provided substantially contributed to the action by causing the expansion of the IRS’s examination.

Example 2. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1–identifies a taxpayer, describes and documents specific facts relating to the taxpayer’s activities, and, based on those facts, alleges that the taxpayer owed additional taxes in Year 1. The IRS proceeds with an examination of the taxpayer for Year 1 based on the information provided. The IRS discovers that the taxpayer engaged in different activities from those described in the information provided with respect to Taxpayer 1. For purposes of sections 7623 and §§ 301.7623–1 through 301.7623–4, the examination of Taxpayer 2 is a related action be-
cause it satisfies the conditions of paragraph (c)(1) of this section. The examination of Taxpayer 3 is not a related action because the relevant facts are not substantially the same as the facts relevant to the examination of Taxpayer 1.

Example 2. Same facts as Example 1. Using the information provided by the whistleblower, the IRS identifies a co-promoter of CPA 1 (CPA 2) that appears to have engaged in activities similar to CPA 1. CPA 2 is not a member of CPA 1’s firm. The IRS subsequently obtains the client list of CPA 2 and identifies a taxpayer/client of CPA 2 (Taxpayer 4) that appears to have engaged in activities similar to Taxpayer 1. The IRS proceeds with an examination of Taxpayer 4 and finds that Taxpayer 4 engaged in the same activities as those described in the information provided with respect to Taxpayer 1, and that CPA 2 contributed to the activities in the same way as described in the information provided with respect to CPA 1. The IRS proceeds with an examination of CPA 2’s liability for promoter penalties under section 6700 in connection with the activities described in the information provided with respect to Taxpayer 1 and CPA 1. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the examination of CPA 2 is a related action because it satisfies the conditions of paragraph (c)(1) of this section. The examination of Taxpayer 4 is not a related action because Taxpayer 4 was not related to a person identified in the information provided. CPA 2 was not identified in the information provided and the IRS first had to identify CPA 2 before identifying Taxpayer 4 and proceeding with the examination of Taxpayer 4.

Example 3. Same facts as Example 1. An accountant (CPA 3) is a member of CPA 1’s firm. Using the information provided by the whistleblower, the IRS obtains the client list of CPA 3 and identifies a taxpayer/client of CPA 3 (Taxpayer 5) that appears to have engaged in activities similar to Taxpayer 1. The IRS proceeds with an examination of Taxpayer 5 and finds that Taxpayer 5 engaged in the same activities as those described in the information provided with respect to Taxpayer 1, and that CPA 3 contributed to the activities in the same way as described in the information provided with respect to CPA 1. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the examination of Taxpayer 5 is a related action because Taxpayer 5 is related to CPA 3, a person considered to be identified in the information provided under § 301.7623–1(c)(1), and the facts relating to Taxpayer 5 are substantially the same as the facts described and documented in the information provided. An IRS examination of CPA 3’s liability for promoter penalties under section 6700, based on the facts described and documented in the information provided with respect to Taxpayer 1 and CPA 1, is an administrative action based on the information provided.

Example 4. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1, identifies a taxpayer (Taxpayer 1), describes and documents specific facts relating to Taxpayer 1’s activities, and, in particular, Taxpayer 1’s participation in a transaction. Based on those facts, the whistleblower alleges that Taxpayer 1 owed additional taxes. The IRS proceeds with an examination of Taxpayer 1 based on the information provided by the whistleblower. The IRS identifies the other parties to the transaction described in the information provided (Taxpayer 2 and Taxpayer 3). The IRS proceeds with examinations of Taxpayer 2 and Taxpayer 3 relating to their participation in the transaction described in the information provided. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the IRS’s examinations of Taxpayer 2 and Taxpayer 3 relating to the activities described and documented in the information provided are related actions because they satisfy the conditions of paragraph (c)(1) of this section.

(d) Collected proceeds. (1) In general. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the terms proceeds of amounts collected and collected proceeds (collectively, collected proceeds) include: tax, penalties, interest, additions to tax, and additional amounts collected because of the information provided; amounts collected prior to receipt of the information if the information provided results in the denial of a claim for refund that otherwise would have been paid; and a reduction of an overpayment credit balance used to satisfy a tax liability incurred because of the information provided. Collected proceeds are limited to amounts collected under the provisions of title 26, United States Code.

(2) Refund netting. (i) In general. If any portion of a claim for refund that is substantively unrelated to the information provided is—

(A) Allowed, and

(B) Used to satisfy a tax liability attributable to the information provided instead of refunded to the taxpayer, then the allowed but non-refunded amount constitutes collected proceeds.

(ii) Example. The provisions of paragraph (d)(2)(i) of this section may be illustrated by the following example:

Example. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1, identifies a corporate taxpayer (Corporation), describes and documents specific facts relating to Corporation’s activities, and, based on those facts, alleges that Corporation owed additional taxes. Based on the information provided by the whistleblower, the IRS proceeds with an examination of Corporation and determines adjustments that would result in an unpaid tax liability of $500,000. During the examination, Corporation informally claims a refund of $400,000 based on adjustments to items of income and expense that are wholly unrelated to the information provided by the whistleblower. The IRS agrees to the unrelated adjustments. The IRS nets the adjustments and determines a tax deficiency of $100,000. Thereafter, Corporation makes full payment of the $100,000 deficiency. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the collected proceeds include the $400,000 informally claimed as a refund and netted against the adjustments attributable to the information provided, as well as the $100,000 paid by Corporation.

(3) Amended returns. Amounts collected based on amended returns constitute collected proceeds if—

(i) The IRS proceeds based on the information provided;

(ii) As a result, the person subject to the action(s) with which the IRS proceeds files amended returns; and

(iii) The amounts collected based on the amended returns relate to the activities or facts described in the information provided.

(4) Criminal fines. Criminal fines deposited into the Victims of Crime Fund are not collected proceeds and cannot be used for payment of awards.

(5) Computation of collected proceeds. (i) In general. Pursuant to § 301.7623–4(d)(1), the IRS cannot make an award payment until there has been a final determination of tax. For purposes of determining the amount of an award under section 7623 and §§ 301.7623–1 through 301.7623–4, after there has been a final determination of tax as defined in § 301.7623–4(d)(2), the IRS will compute the amount of collected proceeds based on all information known with respect to the taxpayer’s account, including with respect to all tax attributes, as of the date the computation is made.

(ii) Post-determination proceeds. If, based on all information known with respect to the taxpayer’s account as of the date of the computation described in paragraph (d)(5)(i) of this section, there is a possibility that the IRS may collect additional proceeds, then the Whistleblower Office will continue to monitor the case. If the Whistleblower Office identifies additional collected proceeds, then the IRS will compute and pay accordingly.

(iii) Partial collection. If the IRS does not collect the full amount of taxes, penalties, interest, additions to tax, and additional amounts assessed against the taxpayer, then any amounts that the IRS does collect will constitute collected proceeds in the same proportion that the adjust-
ments attributable to the information provided bear to the total adjustments.

(e) Amount in dispute and gross income. (1) In general. Section 7623(b) applies with respect to any action against any taxpayer in which the tax, penalties, interest, additions to tax, and additional amounts in dispute exceed $2,000,000 but, if the taxpayer is an individual, then only if the taxpayer’s gross income exceeds $200,000 in at least one taxable year subject to the action.

(2) Amount in dispute. (i) In general. For purposes of section 7623(b)(5) and §§ 301.7623–1 through 301.7623–4, the term amount in dispute means the greater of the maximum total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action(s) with which the IRS proceeded based on the information provided, or the maximum total of such amounts that were stated in formal positions taken by the IRS in the action(s). The IRS will compute the amount in dispute, for purposes of award determinations described in § 301.7623–3(c)(6), when there has been a final determination of tax as defined in § 301.7623–4(d)(2).

(ii) Examples. The provisions of paragraph (e)(2)(i) of this section may be illustrated by the following examples:

Example 1. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1, identifies a corporate taxpayer, describes and documents specific facts relating to the taxpayer’s activities, and, based on those facts, alleges that the taxpayer owed additional taxes. The IRS proceeds with an examination of the taxpayer based on the information provided by the whistleblower; makes adjustments to items of income and expense and allows certain credits; and, ultimately, determines a deficiency against the taxpayer of $1,900,000 and issues the taxpayer a statutory notice of deficiency. The taxpayer petitions the notice to the United States Tax Court. The Tax Court sustains the IRS’s position resulting in a deficiency of $1,900,000. Following the final determination of tax, the IRS computes that the total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action was $2,500,000. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the amount in dispute is $2,500,000.

Example 2. Same facts as Example 1, except the IRS determines a deficiency of $1,500,000; the Tax Court sustains the deficiency of $1,500,000; and, following the final determination of tax, the IRS computes that the total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action was $1,750,000. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the amount in dispute is $1,750,000.

Example 3. Same facts as Example 1, except the IRS determines a deficiency of $2,100,000; the Tax Court redetermines a deficiency of $1,500,000; and, following the final determination of tax, the IRS computes that the total of tax, penalties, interest, additions to tax, and additional amounts that resulted from the action was $1,750,000. For purposes of section 7623 and §§ 301.7623–1 through 301.7623–4, the amount in dispute is $2,100,000.

(3) Gross income. For purposes of section 7623(b)(5) and §§ 301.7623–1 through 301.7623–4, the term gross income has the same meaning as provided under section 61(a). The IRS will compute the individual taxpayer’s gross income, for purposes of award determinations described in § 301.7623–3(c)(6), when there has been a final determination of tax as defined in § 301.7623–4(d)(2).

(f) Effective/applicability date. This rule is effective on August 12, 2014. This rule applies to information submitted on or after August 12, 2014, and to claims for award under sections 7623(a) and 7623(b) that are open as of August 12, 2014.

Par. 5. Section 301.7623–3 is added to read as follows:

§ 301.7623–3 Whistleblower administrative proceedings and appeals of award determinations.

(a) In general. The Whistleblower Office will pay awards under section 7623(a) and determine and pay awards under section 7623(b) in whistleblower administrative proceedings pursuant to the rules of this section. The whistleblower administrative proceedings described in this section are administrative proceedings pertaining to tax administration for purposes of section 6103(h)(4). See § 301.6103(h)(4)–1 for additional rules regarding disclosures of return information in whistleblower administrative proceedings. The Whistleblower Office may determine awards for claims involving multiple actions in a single whistleblower administrative proceeding. For purposes of the whistleblower administrative proceedings for rejections and denials, described in paragraphs (b)(3), (c)(7), and (c)(8) of this section, the Internal Revenue Service (IRS) may rely on the whistleblower’s description of the amount owed by the taxpayer(s). The IRS may, however, rely on other information as necessary (for example, when the alleged amount in dispute is below the $2 million threshold of section 7623(b)(5)(B), but the actual amount in dispute is above the threshold).

(b) Awards under section 7623(a). (1) Preliminary award recommendation. In cases in which the Whistleblower Office recommends payment of an award under section 7623(a), the Whistleblower Office will communicate a preliminary award recommendation under section 7623(a) and §§ 301.7623–1 through 301.7623–4 to the whistleblower by sending a preliminary award recommendation letter that states the Whistleblower Office’s preliminary computation of the amount of collected proceeds, recommended award percentage, recommended award amount (even in cases when the application of § 301.7623–4 results in a reduction of the recommended award amount to zero), and a list of the factors that contributed to the recommended award percentage. The whistleblower administrative proceeding described in paragraphs (b)(1) and (2) of this section begins on the date the Whistleblower Office sends the preliminary award recommendation letter. If the whistleblower believes that the Whistleblower Office erred in evaluating the information provided, the whistleblower has 30 days from the date the Whistleblower Office sends the preliminary award recommendation to submit comments to the Whistleblower Office (this period may be extended at the sole discretion of the Whistleblower Office). The Whistleblower Office will review all comments submitted timely by the whistleblower (or the whistleblower’s legal representative, if any) and pay an award, pursuant to paragraph (b)(2) of this section.

(2) Decision letter. At the conclusion of the process described in paragraph (b)(1) of this section, and when there is a final determination of tax, as defined in § 301.7623–4(d)(2), the Whistleblower Office will pay an award under section 7623(a) and §§ 301.7623–1 through 301.7623–4. The Whistleblower Office will communicate the amount of the award to the whistleblower in a decision letter.

(3) Rejections and denials. If the Whistleblower Office rejects a claim for award under section 7623(a), pursuant to
Awards under section 7623(b). (1) Preliminary award recommendation. For claims under section 7623(b) other than those described in paragraphs (c)(7) and (c)(8) of this section (rejections and denials), the Whistleblower Office will prepare a preliminary award recommendation based on the Whistleblower Office’s review of the administrative claim file and the application of the rules of section 7623 and §§ 301.7623–1 through 301.7623–4 to the facts of the case. See paragraph (e)(2) of this section for a description of the administrative claim file. The whistleblower administrative proceeding described in paragraphs (c)(1) through (6) of this section begins on the date the Whistleblower Office sends the preliminary award recommendation letter. The preliminary award recommendation is not a determination letter within the meaning of paragraph (c)(6) of this section and cannot be appealed to Tax Court under section 7623(b)(4) and paragraph (d) of this section. The preliminary award recommendation will notify the whistleblower that the IRS cannot determine or pay any award until there is a final determination of tax, as defined in § 301.7623–4(d)(2).

(2) Contents of preliminary award recommendation. The Whistleblower Office will communicate the preliminary award recommendation under section 7623(b) to the whistleblower by sending—

(i) A preliminary award recommendation letter that describes the whistleblower’s options for responding to the preliminary award recommendation;

(ii) A summary report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, the recommended award amount (even in cases when the application of section 7623(b)(2) or section 7623(b)(3) results in a reduction of the recommended award amount to zero), and a list of the factors that contributed to the recommended award percentage;

(iii) An award consent form; and

(iv) A confidentiality agreement.

(3) Opportunity to respond to preliminary award recommendation. The whistleblower will have 30 days (this period may be extended at the sole discretion of the Whistleblower Office) from the date the Whistleblower Office sends the preliminary award recommendation letter to respond to the preliminary award recommendation in one of the following ways—

(i) If the whistleblower takes no action, then the Whistleblower Office will make an award determination, pursuant to paragraph (c)(6) of this section;

(ii) If the whistleblower signs, dates, and returns the award consent form agreeing to the preliminary award recommendation and waiving any and all administrative and judicial appeal rights, then the Whistleblower Office will make an award determination, pursuant to paragraph (c)(6) of this section;

(iii) If the whistleblower signs, dates, and returns the confidentiality agreement, then the Whistleblower Office will provide the whistleblower with a detailed award report, and an opportunity to review documents supporting the report pursuant to paragraphs (c)(4) and (5) of this section, and any comments submitted by the whistleblower will be added to the administrative claim file; or

(iv) If the whistleblower submits comments on the preliminary award recommendation to the Whistleblower Office, but does not sign, date, and return the confidentiality agreement, then the comments will be added to the administrative claim file and reviewed by the Whistleblower Office in making an award determination, pursuant to paragraph (c)(6) of this section.

(4) Detailed report. (i) Contents of detailed report. If the whistleblower signs, dates, and returns the confidentiality agreement accompanying the preliminary award recommendation under section 7623(b), pursuant to paragraph (c)(3) of this section, then the Whistleblower Office will send the whistleblower—

(A) A detailed report that states a preliminary computation of the amount of collected proceeds, the recommended award percentage, and the recommended award amount, and provides a full explanation of the factors that contributed to the recommended award percentage;

(B) Instructions for scheduling an appointment for the whistleblower (and the whistleblower’s legal representative, if any) to review information in the administrative claim file that is not protected by one or more common law or statutory privileges; and

(C) An award consent form.

(ii) Opportunity to respond to detailed report. The whistleblower will have 30 days (this period may be extended at the sole discretion of the Whistleblower Office) from the date the Whistleblower Office sends the detailed report to respond in one of the following ways—

(A) If the whistleblower takes no action, then the Whistleblower Office will make an award determination, pursuant to paragraph (c)(6) of this section;

(B) If the whistleblower requests an appointment to review information from the administrative claim file that is not protected from disclosure by one or more common law or statutory privileges, then a meeting will be arranged pursuant to paragraph (c)(5) of this section;

(C) If the whistleblower does not request an appointment but does submit comments on the detailed report to the Whistleblower Office, then the comments will be added to the administrative claim file and reviewed by the Whistleblower Office in making an award determination pursuant to paragraph (c)(6) of this section; or

(D) If the whistleblower signs, dates, and returns the award consent form agreeing to the preliminary award recommendation and waiving any and all administrative and judicial appeal rights, then the Whistleblower Office will make an award determination, pursuant to paragraph (c)(6) of this section.

(iii) Additional rules. The detailed report is not a determination letter within the meaning of paragraph (c)(6) of this section and cannot be appealed to Tax Court under section 7623(b)(4) and paragraph (d) of this section. The detailed report will notify the whistleblower that
the IRS cannot determine or pay any award until there is a final determination of tax, as defined in § 301.7623–4(d)(2).

(5) Opportunity to review documents supporting award report recommendations. Appointments for the whistleblower (and the whistleblower’s legal representative, if any) to review information from the administrative claim file that is not protected from disclosure by one or more common law or statutory privileges will be held at the Whistleblower Office in Washington, D.C., unless the Whistleblower Office, in its sole discretion, decides to hold the meeting at another location. At the appointment, the Whistleblower Office will provide for viewing the information from the administrative claim file. The Whistleblower Office will supervise the whistleblower’s review of the information and the whistleblower will not be permitted to make copies of any documents or other information. The whistleblower will have 30 days (this period may be extended at the sole discretion of the Whistleblower Office) from the date of the appointment to submit comments on the detailed report and the documents reviewed at the appointment to the Whistleblower Office. All comments will be added to the administrative claim file and reviewed by the Whistleblower Office in making an award determination, pursuant to paragraph (c)(6) of this section.

(6) Determination letter. After the whistleblower’s participation in the whistleblower administrative proceeding, pursuant to paragraph (c) of this section, has concluded, and there is a final determination of tax, as defined in § 301.7623–4(d)(2), a Whistleblower Office official will determine the amount of the award under section 7623(b)(1), (2), or (3), and §§ 301.7623–1 through 301.7623–4, based on the official’s review of the administrative claim file. The Whistleblower Office will communicate the award to the whistleblower in a determination letter, stating the amount of the award. If, however, the whistleblower has executed an award consent form agreeing to the amount of the award and waiving the whistleblower’s right to appeal the award determination, pursuant to section 7623(b)(4) and paragraph (d) of this section, then the Whistleblower Office will not send the whistleblower a determination letter and will make payment of the award as promptly as circumstances permit.

(7) Rejections. A rejection is a determination that relates solely to the whistleblower and the information on the face of the claim that pertains to the whistleblower. If the Whistleblower Office rejects a claim for award under section 7623(b), pursuant to § 301.7623–1(b) or (c), then the Whistleblower Office will not apply the rules of paragraphs (c)(1) through (6) of this section. The Whistleblower Office will send to the whistleblower a preliminary rejection letter that states the basis for the rejection of the claim. The whistleblower administrative proceeding described in this paragraph begins on the date the Whistleblower Office sends the preliminary rejection letter. If the whistleblower believes that the Whistleblower Office erred in evaluating the information provided, the whistleblower has 30 days from the date the Whistleblower Office sends the preliminary denial letter to submit comments to the Whistleblower Office (this period may be extended at the sole discretion of the Whistleblower Office). The Whistleblower Office will review all comments submitted timely by the whistleblower (or the whistleblower’s legal representative, if any) and, following that review, the Whistleblower Office will either provide written notice to the whistleblower of the denial of any award, including the basis for the denial, or apply the rules of paragraphs (c)(1) through (c)(6) of this section.

(d) Appeal of award determination. Any determination regarding an award under section 7623(b)(1), (2), or (3) may, within 30 days of such determination, be appealed to the Tax Court.

(e) Administrative record. (1) In general. The administrative record comprises all information contained in the administrative claim file that is relevant to the award determination and not protected by one or more common law or statutory privileges.

(2) Administrative claim file. The administrative claim file will include the following materials relating to the action(s) to which the determination relates—

(i) The Form 211, “Application for Award for Original Information,” filed by the whistleblower and all information provided by the whistleblower (whether provided with the whistleblower’s original submission or through a subsequent contact with the IRS).

(ii) Copies of all debriefing notes and recorded interviews held with the whistleblower (and the whistleblower’s legal representative, if any).

(iii) Form(s) 11369, “Confidential Evaluation Report on Claim for Award,” including narratives prepared by the relevant IRS office(s), explaining the whistleblower’s contributions to the actions and documenting the actions taken by the IRS in the case(s). The Form 11369 will refer to and incorporate additional documents relating to the issues raised by the claim, as appropriate, including, for example, relevant portions of revenue agent reports, copies of agreements entered into with the
§ 301.7623–4 Amount and payment of award.

(a) In general. The Whistleblower Office will pay all awards under section 7623(a) and determine and pay all awards under section 7623(b). For all awards under section 7623 and §§ 301.7623–1 through 301.7623–4, the Whistleblower Office will—

(1) Analyze the claim by applying the rules provided in paragraph (c) of this section to the information contained in the administrative claim file to determine an award percentage; and

(2) Multiply the award percentage by the amount of collected proceeds. If the award determination arises out of a single whistleblower administrative proceeding involving multiple actions, the Whistleblower Office may determine separate award percentages on an action-by-action basis and apply the separate award percentages to the collected proceeds attributable to the corresponding actions. The Internal Revenue Service (IRS) will pay all awards in accordance with the rules provided in paragraph (d) of this section.

(b) Factors used to determine award percentage. (1) Positive factors. The application of the following non-exclusive factors may support increasing an award percentage under paragraphs (c)(1) or (2) of this section—

(i) The whistleblower acted promptly to inform the IRS or the taxpayer of the tax noncompliance.

(ii) The information provided identified an issue or transaction of a type previously unknown to the IRS.

(iii) The information provided identified taxpayer behavior that the IRS was unlikely to identify or that was particularly difficult to detect through the IRS’s exercise of reasonable diligence.

(iv) The information provided thoroughly presented the factual details of tax noncompliance in a clear and organized manner, particularly if the manner of the presentation saved the IRS work and resources.

(v) The whistleblower (or the whistleblower’s legal representative, if any) provided extensive cooperation and assistance during thependency of the action(s).

(vi) The information provided identified assets of the taxpayer that could be used to pay liabilities, particularly if the assets were not otherwise known to the IRS.

(vii) The information provided identified connections between transactions, or parties to transactions, that enabled the IRS to understand tax implications that might not otherwise have been understood by the IRS.

(viii) The information provided had an impact on the behavior of the taxpayer, for example by causing the taxpayer to promptly correct a previously-reported improper position.

(2) Negative factors. The application of the following non-exclusive factors may support decreasing an award percentage under paragraphs (c)(1) or (2) of this section—

(i) The whistleblower delayed informing the IRS after learning the relevant facts, particularly if the delay adversely affected the IRS’s ability to pursue an action or issue.

(ii) The whistleblower contributed to the underpayment of tax or tax noncompliance identified.

(iii) The whistleblower directly or indirectly profited from the underpayment of tax or tax noncompliance identified, but did not plan and initiate the actions that led to the underpayment of tax or actions described in section 7623(a)(2).

(iv) The whistleblower (or the whistleblower’s legal representative, if any) negligently affected the IRS’s ability to pursue the action(s), for example by disclosing the existence or scope of an enforcement activity.

(v) The whistleblower (or the whistleblower’s legal representative, if any) violated instructions provided by the IRS, particularly if the violation caused the IRS to expend additional resources.

(vi) The whistleblower (or the whistleblower’s legal representative, if any) violated the terms of the confidentiality agreement described in § 301.7623– 3(c)(2)(iv).

(vii) The whistleblower (or the whistleblower’s legal representative, if any) violated the terms of a contract entered into with the IRS pursuant to § 301.6103(n)–2.

(viii) The whistleblower provided false or misleading information or otherwise violated the requirements of section 7623(b)(6)(C) or § 301.7623–1(c)(3).

(c) Amount of award percentage. (1) Award for substantial contribution. (i) In general. If the IRS proceeds with any administrative or judicial action based on information brought to the IRS’s attention by a whistleblower, such whistleblower shall, subject to paragraphs (c)(2) and (3) of this section, receive as an award at least 15 percent but not more than 30 percent of
the collected proceeds resulting from the action (including any related actions) or from any settlement in response to such action. The amount of any award under this paragraph depends on the extent of the whistleblower's substantial contribution to the action(s). See paragraph (c)(4) of this section for rules regarding multiple whistleblowers.

(ii) Computational framework. Starting the analysis at 15 percent, the Whistleblower Office will analyze the administrative claim file using the factors listed in paragraph (b)(1) of this section to determine whether the whistleblower merits an increased award percentage of 22 percent or 30 percent. The Whistleblower Office may increase the award percentage based on the presence and significance of positive factors. The Whistleblower Office will then analyze the contents of the administrative claim file using the factors listed in paragraph (b)(2) of this section to determine whether the whistleblower merits a decreased award percentage of 15 percent, 18 percent, 22 percent, or 26 percent. The Whistleblower Office may decrease the award percentage based on the presence and significance of negative factors. Although the factors listed in paragraph (b)(1) and (2) of this section are described as positive and negative factors, the Whistleblower Office’s analysis cannot be reduced to a mathematical equation. The factors are not exclusive and are not weighted and, in a particular case, one factor may override several others. The presence and significance of positive factors may offset the presence and significance of negative factors. But the absence of negative factors does not constitute a positive factor.

(iii) Examples. The operation of the provisions of paragraph (c)(1)(ii) of this section may be illustrated by the following examples. The examples are intended to illustrate the operation of the computational framework. The examples provide simplified descriptions of the facts relating to the claims for award, the information provided, and the facts relating to the underlying tax cases. The application of section 7623(b)(1) and paragraph (c)(1)(ii) of this section will depend on the specific facts of each case.

Example 1. Facts. Whistleblower A, an employee in Corporation’s sales department, submitted to the IRS a claim for award under section 7623 and information indicating that Corporation improperly claimed a credit in tax year 2006. Whistleblower A’s information consisted of numerous non-privileged documents relevant to Corporation’s eligibility for the credit. Whistleblower A’s original submission also included an analysis of the documents, as well as information about meetings in which the claim for credit was discussed. When interviewed by the IRS, Whistleblower A clarified ambiguities in the original submission, answered questions about Corporation’s business and accounting practices, and identified potential sources to corroborate the information.

Some of the documents provided by Whistleblower A were not included in Corporation’s general record-keeping system and their existence may not have been easily uncovered through normal IRS examination procedures. Corporation initially denied the facts revealed in the information provided by Whistleblower A, which were essential to establishing the improbity of the claim for credit. IRS examination of Corporation’s return confirmed that the credit was improperly claimed by Corporation in tax year 2006, as alleged by Whistleblower A. Corporation agreed to the ensuing assessments of tax and interest and paid the liabilities in full.

Analysis. In this case, Whistleblower A provided specific and credible information that formed the basis for action by the IRS. Whistleblower A provided information that was difficult to detect, provided useful assistance to the IRS, and helped the IRS sustain the assessment. Based on the presence and significance of these positive factors, Whistleblower Office could increase the award percentage to 22 percent of collected proceeds. If, however, Whistleblower A’s claim reflected negative factors, for example Whistleblower A violated instructions provided by the IRS and the violation caused the IRS to expend additional resources, then the Whistleblower Office could, based on this negative factor, reduce the award percentage to 18 or 15 percent (but not to lower than 15 percent of collected proceeds).

Example 2. Facts. Whistleblower B, an employee of Financial Advisory Firm 1 (Firm 1), submitted to the IRS a claim for award under section 7623 and information indicating that Firm 1 helped clients engage in activities that may have a positive effect on client behavior and save IRS resources. Based on the presence and significance of these positive factors, the Whistleblower Office could increase the award percentage to 20 percent of collected proceeds. If Whistleblower B directly or indirectly profited from Firm 1’s and the clients’ activities resulting in the tax underpayments, then the Whistleblower Office could, based on this negative factor, reduce the award percentage to 26, 22, 18 percent or 15 percent (but not to lower than 15 percent of collected proceeds).

The Whistleblower Office determines that the action described in paragraph (c)(1) of this section is based principally on disclosures of specific allegations resulting from a judicial or administrative hearing; a government report, hearing, audit, or investigation; or the news media, then the Whistleblower Office will determine an award of no more than 10 percent of the collected proceeds resulting from the action (including any related actions) or from any settlement in response to such action. If the whistleblower is the original source of the information from which the disclosures of specific allegations resulted, however, then the award percentage will be determined under paragraph (c)(1) of this section.
(ii) **Computational framework.** The Whistleblower Office will analyze the administrative claim file to determine—

(A) Whether the claim involves specific allegations regarding a tax underpayment or a violation of the internal revenue laws that reasonably may be inferred to have resulted from a judicial or administrative hearing; a government report, hearing, audit, or investigation; or the news media;

(B) Whether the action described in paragraph (c)(1) of this section was based principally on the disclosure of the specific allegations; and

(C) Whether the whistleblower was the original source of the information that gave rise to the specific allegations. If the Whistleblower Office determines that the action was based principally on disclosures of specific allegations, as stated in paragraph (c)(2)(ii)(B) of this section, and that the whistleblower was not the original source of the information, then, starting at 1 percent, the Whistleblower Office will analyze the administrative claim file using the factors listed in paragraph (b)(1) of this section to determine whether the whistleblower merits an increased award percentage of 4 percent, 7 percent, or 10 percent. The Whistleblower Office will then determine whether the whistleblower merits a decreased award percentage of zero, 1 percent, 4 percent, or 7 percent using the factors listed in paragraph (b)(2) of this section. The Whistleblower Office may increase the award percentage based on the presence and significance of positive factors and may decrease (to zero) the award percentage based on the presence and significance of negative factors. Like the analysis described in paragraph (c)(1)(ii) of this section, the Whistleblower Office’s analysis cannot be reduced to a mathematical equation. The factors are not exclusive and are not weighted and, in a particular case, one factor may override several others. The presence and significance of positive factors may offset the presence and significance of negative factors. But the absence of negative factors does not constitute a positive factor.

(iii) **Example.** The operation of the provisions of paragraph (c)(2)(ii) of this section may be illustrated by the following example. The example is intended to illustrate the operation of the computational framework. The example provides a simplified description of the facts relating to the claim for award, the information provided, and the facts relating to the underlying tax case(s). The application of section 7623(b)(2) and paragraph (c)(2)(ii) of this section will depend on the specific facts of each case.

**Example.** Facts. Whistleblower A submitted to the IRS a claim for award under section 7623 and information indicating that Taxpayer B was the defendant in a criminal prosecution for embezzlement. Whistleblower A’s information further indicated that evidence presented at Taxpayer B’s trial revealed Taxpayer B’s efforts to conceal the embezzled funds by depositing them in bank accounts of entities controlled by Taxpayer B. Taxpayer B’s failure to pay tax on the embezzled funds was not explicitly stated during the judicial hearing, but could be reasonably inferred from the facts and circumstances, including Taxpayer B’s efforts to conceal the funds.

Analysis. In this case, Whistleblower A’s information is based principally on disclosures of specific allegations resulting from a judicial hearing. Absent information demonstrating that the investigation leading to the embezzlement charge was based on information provided by Whistleblower A, section 7623(b)(2) and paragraph (c)(2) of this section apply to the determination of Whistleblower A’s award. In this case, there is no reason for the Whistleblower Office to increase the applicable award percentage above 1 percent, the starting point for its analysis, given the absence of positive factors. Accordingly, Whistleblower A may receive an award of 1 percent of collected proceeds.

(3) **Reduction in award and denial of award.**

(i) In general. If the Whistleblower Office determines that a claim for award is brought by a whistleblower who planned and initiated the actions, transactions, or events (underlying acts) that led to the underpayment of tax or actions described in section 7623(a)(2), then the Whistleblower Office may appropriately reduce the amount of the award percentage that would otherwise result under section 7623(b)(1) and paragraph (c)(1) of this section or section 7623(b)(2) and paragraph (c)(2) of this section, as applicable, the Whistleblower Office will analyze the administrative claim file to make the threshold determination described in paragraph (c)(3)(ii) of this section. If the whistleblower is determined to have planned and initiated the underlying acts, then the Whistleblower Office will reduce the award based on the extent of the whistleblower’s planning and initiating, pursuant to paragraph (c)(3)(iii) of this section.

(ii) **Threshold determination.** A whistleblower planned and initiated the underlying acts if the whistleblower—

(A) Designed, structured, drafted, arranged, formed the plan leading to, or otherwise planned, an underlying act,

(B) Took steps to start, introduce, originate, set into motion, promote or otherwise initiate an underlying act, and

(C) Knew or had reason to know that an underpayment of tax or actions described in section 7623(a)(2) could result from planning and initiating the underlying act.

(D) The whistleblower need not have been the sole person involved in planning and initiating the underlying acts. A whistleblower who merely furnishes typing, reproducing, or other mechanical assistance in implementing one or more underlying acts will not be treated as initiating any underlying act. A whistleblower who is a junior employee acting at the direction, and under the control, of a senior employee will not be treated as initiating any underlying act.

(E) If the Whistleblower Office determines that a whistleblower has satisfied this initial threshold of planning and initiating, the Whistleblower Office will then reduce the award amount based on the extent of the whistleblower’s planning and initiating, pursuant to paragraph (c)(3)(iii) of this section.

(iii) **Computational framework.** After determining the award percentage that would otherwise result from the application of section 7623(b)(1) and paragraph (c)(1) of this section or section 7623(b)(2) and paragraph (c)(2) of this section, as applicable, the Whistleblower Office will analyze the administrative claim file to make the threshold determination described in paragraph (c)(3)(ii) of this section. If the whistleblower is determined to have planned and initiated the underlying acts, then the Whistleblower Office will reduce the award based on the extent of the whistleblower’s planning and initiating. The Whistleblower Office’s analysis and the amount of the appropriate reduction determined in a particular case cannot be reduced to a mathematical equation. To determine the appropriate award reduction, the Whistleblower Office will—

(A) Categorize the whistleblower’s role as a planner and initiator as primary, significant, or moderate; and

(B) Appropriately reduce the award percentage that would otherwise result
from the application of section 7623(b)(1) and paragraph (c)(1) of this section or section 7623(b)(2) and paragraph (c)(2) of this section, as applicable, by 67 percent to 100 percent in the case of a primary planner and initiator, by 34 percent to 66 percent in the case of a significant planner and initiator, or by 0 percent to 33 percent in the case of a moderate planner and initiator. If the whistleblower is convicted of criminal conduct arising from his or her role in planning and initiating the underlying acts, then the Whistleblower Office will deny an award without regard to whether the Whistleblower Office categorized the whistleblower’s role as a planner and initiator as primary, significant, or moderate.

(iv) Factors demonstrating the extent of a whistleblower’s planning and initiating. The application of the following non-exclusive factors may support a determination of the extent of a whistleblower’s planning and initiating of the underlying acts—

(A) The whistleblower’s role as a planner and initiator. Was the whistleblower the sole decision-maker or one of several contributing planners and initiators? To what extent was the whistleblower acting under the direction and control of a supervisor?

(B) The nature of the whistleblower’s planning and initiating activities. Was the whistleblower involved in legitimate tax planning activities? Did the whistleblower take steps to hide the actions at the planning stage? Did the whistleblower commit any identifiable misconduct (legal, ethical, etc.)?

(C) The extent to which the whistleblower knew or should have known that tax noncompliance could result from the course of conduct.

(D) The extent to which the whistleblower acted in furtherance of the noncompliance, including, for example, efforts to conceal or disguise the transaction.

(E) The whistleblower’s role in identifying and soliciting others to participate in the actions reported, whether as parties to a common transaction or as parties to separate transactions.

(v) Examples. The operation of the provisions of paragraphs (c)(3)(i) and (iii) of this section may be illustrated by the following examples. These examples are intended to illustrate the operation of the computational framework. The examples provide simplified descriptions of the facts relating to the claim for award, the information provided, and the facts relating to the underlying tax case. The application of section 7623(b)(3) and paragraph (c)(3) of this section will depend on the specific facts of each case.

Example 1. Facts. Whistleblower A is employed as a junior associate in a law firm and is responsible for performing research and drafting activities for, and under the direction and control of, partners of the law firm. Whistleblower A performed research on financial products for Partner B that Partner B used in advising a client (Corporation 1) on a financial strategy. After Corporation 1 executed the strategy, Whistleblower A submitted a claim for award under section 7623 along with information about the strategy to the IRS. The IRS initiated an examination of Corporation 1 based on Whistleblower A’s information, determined deficiencies in tax and penalties, and ultimately assessed and collected the tax and penalties as determined.

Analysis. Whistleblower A did nothing to design or set into motion Corporation 1’s activities. Whistleblower A did not know or have reason to know that an underpayment of tax or actions described in section 7623(a)(2) could result from the research and drafting activities. Accordingly, as a threshold matter, Whistleblower A was not a planner and initiator of Corporation 1’s strategy, and the award that would otherwise be determined based on the application of section 7623(b)(1) and paragraph (c)(1) of this section is not subject to reduction under section 7623(b)(3) and paragraph (c)(3) of this section.

Example 2. Facts. Whistleblower C is employed in the human resources department of a corporation (Corporation 2). Corporation 2 tasked Whistleblower C with hiring a large number of temporary employees to meet Corporation 2’s seasonal business demands. Whistleblower C organized, scheduled, and conducted job fairs and job interviews to hire the seasonal employees. Whistleblower C was not responsible for, had no knowledge of, and played no part in, classifying the seasonal employees.

Analysis. The award that would otherwise be determined based on the application of section 7623(b)(1) and paragraph (c)(1) of this section would be subject to an appropriate reduction under section 7623(b)(3) and paragraph (c)(3) of this section because Whistleblower C did not satisfy the requirements of the threshold determination of a planner and initiator.

Example 3. Facts. Whistleblower D is employed as a supervisor in the finance department of a corporation (Corporation 3) and is responsible for planning Corporation 3’s overall financial strategy. Pursuant to the overall financial strategy, Whistleblower D and others at Corporation 3, in good faith but incorrectly, planned tax-advantaged transactions. Whistleblower D and others at Corporation 3 prepared documents needed to execute the transactions. After Corporation 3 executed the transactions, Whistleblower D reached the conclusion that the tax consequences claimed were incorrect and Whistleblower D submitted a claim for award under section 7623 along with non-privileged information about the transactions to the IRS. The IRS initiated an examination of Corporation 3 based on Whistleblower D’s information, determined deficiencies in tax and penalties, and ultimately assessed and collected the tax and penalties as determined.

Analysis. The award that would otherwise be determined based on the application of section 7623(b)(1) and paragraph (c)(1) of this section would be subject to an appropriate reduction under section 7623(b)(3) and paragraph (c)(3) of this section because Whistleblower D satisfies the requirements of the threshold determination of a planner and initiator.

Example 4. Facts. Same facts as Example 3, except that Whistleblower D independently planned a high-risk tax avoidance transaction and prepared draft documents to execute the transaction. Whistleblower D presented the transaction, along with the draft documents, to Corporation 3’s Chief Financial Officer. Without the further involvement of Whistleblower D, Corporation 3’s Chief Financial Officer, Chief Executive Officer, and Board of Directors subsequently approved the execution of the transaction. After Corporation 3 executed the transaction, Whistleblower D submitted a claim for award under section 7623 along with non-privileged information about the transaction to the IRS. The IRS initiated an examination of Corporation 3 based on Whistleblower D’s information, determined deficiencies in tax and penalties, and ultimately assessed and collected the tax and penalties as determined.
ties, and ultimately assessed and collected the tax and penalties as determined.

Analysis. The award that would otherwise be determined based on the application of section 7623(b)(1) and paragraph (c)(1) of this section would be subject to an appropriate reduction under section 7623(b)(3) and paragraph (c)(3) of this section because Whistleblower D satisfies the requirements of the threshold determination of a planner and initiator. Whistleblower D planned the transaction, prepared the necessary documents, and knew that an underpayment of tax or actions described in section 7623(a)(2) could result from the transaction. Working independently, Whistleblower D designed and took steps to effectuate the transaction while knowing that the planning and initiating of the transaction was likely to result in tax noncompliance. Whistleblower D, however, did not approve the execution to effectuate the transaction while knowing that actions described in section 7623(a)(2) could result from the transaction. Accordingly, the Whistleblower Office will exercise its discretion to reduce Whistleblower D’s award by 34 to 66 percent.

Example 5. Facts. Whistleblower E is a financial planner. Whistleblower E designed a financial product that the IRS identified as an abusive tax avoidance transaction. Whistleblower E marketed the transaction to taxpayers, facilitated their participation in the transaction, and, initially, took steps to disguise the transaction. After several taxpayers had participated in the transaction, Whistleblower E submitted a claim for award under section 7623 along with nonprivileged information to the IRS about the transaction and the participating taxpayers. The IRS initiated an examination of the identified taxpayers based on Whistleblower E’s information, determined deficiencies in tax and penalties, and ultimately assessed and collected the tax and penalties as determined. Whistleblower E was not criminally prosecuted.

Analysis. The award that would otherwise be determined based on the application of section 7623(b)(1) and paragraph (c)(1) of this section would be subject to an appropriate reduction under section 7623(b)(3) and paragraph (c)(3) of this section because Whistleblower E satisfies the requirements of the threshold determination of a planner and initiator. Whistleblower E designed the financial product, marketed and facilitated its use by taxpayers, and knew that an underpayment of tax or actions described in section 7623(a)(2) could result from the transaction. Whistleblower E was the sole designer of the transaction, solicited clients to participate in the transaction, and facilitated and attempted to conceal their participation in the transaction. Whistleblower E knew that the planning and initiating of the taxpayers’ participation in the transaction was likely to result in an underpayment of tax or actions described in section 7623(a)(2). On the basis of these facts, Whistleblower E was a primary-level planner and initiator. Accordingly, the Whistleblower Office will exercise its discretion to reduce Whistleblower E’s award by 67 to 100 percent.

(4) Multiple whistleblowers. If two or more independent claims relate to the same collected proceeds, then the Whistleblower Office may evaluate the contribution of each whistleblower to the action(s) that resulted in collected proceeds. The Whistleblower Office will determine whether the information submitted by each whistleblower would have been obtained by the IRS as a result of the information previously submitted by any other whistleblower. If the Whistleblower Office determines that multiple whistleblowers submitted information that would not have been obtained based on a prior submission, then the Whistleblower Office will determine the amount of each whistleblower’s award based on the extent to which each whistleblower contributed to the action(s). The aggregate award amount in cases involving two or more independent claims that relate to the same collected proceeds will not exceed the maximum award amount that could have resulted under section 7623(b)(1) or section 7623(b)(2), as applicable, subject to the award reduction provisions of section 7623(b)(3), if a single claim had been submitted.

(d) Payment of Award.

(1) In general. The IRS will pay any award determined under section 7623 and §§ 301.7623–1 through 301.7623–4 to the whistleblower(s) that filed the corresponding claim for award. Payment of an award will be made as promptly as the circumstances permit, but not until there has been a final determination of tax, as defined in paragraph (d)(2) of this section, the Whistleblower Office has determined the award, and all appeals of the Whistleblower Office’s determination are final or the whistleblower has executed an award consent form agreeing to the amount of the award and waiving the whistleblower’s right to appeal the determination.

(2) Final determination of tax.

(i) In general. For purposes of §§ 301.7623–1 through 301.7623–4, a final determination of tax means that the proceeds resulting from the action(s) subject to the award determination have been collected and either the statutory period for filing a claim for refund has expired or the taxpayer(s) subject to the action(s) and the IRS have agreed with finality to the tax or other liabilities for the period(s) at issue and the taxpayer(s) have waived the right to file a claim for refund. A final determination of tax does not preclude a subsequent final determination of tax if the IRS proceeds based on the information provided following the payment, denial, or rejection of an award.

(ii) Example. The provisions of paragraph (d)(2)(i) of this section, regarding subsequent final determination of tax, may be illustrated by the following example:

Example. Information provided to the IRS by a whistleblower, under section 7623 and § 301.7623–1, identifies a taxpayer (Corporation 1), describes and documents specific facts relating to Corporation 1’s activities, and, based on those facts, alleges that Corporation 1 owed additional taxes in Year 1. The Whistleblower Office processes the incoming claim and provides the information to an IRS Operating Division (Operating Division 1). Operating Division 1 reviews the claim and the allegations and ultimately decides not to proceed with an action against Corporation 1. Operating Division 1 conveys its determination not to proceed with an action against Corporation 1 to the Whistleblower Office on a Form 11369 along with all of the relevant supporting documents. The Whistleblower Office provides written notice to the whistleblower, denying any award pursuant to § 301.7623–3(c)(8), and the whistleblower does not appeal the notice to Tax Court within 30 days.

Two months after the Whistleblower Office denies the award, the Whistleblower Office recognizes a potential connection between the information provided and a recently-initiated, ongoing, examination of a second taxpayer by a second IRS Operating Division (Operating Division 2). The Whistleblower Office provides the information to Operating Division 2. Operating Division 2 evaluates the information and proceeds with an action against Taxpayer 2 based on the information provided. Ultimately, Operating Division 2 assesses and collects taxes resulting from the action and totaling $3 million. Following the conclusion of the whistleblower’s participation in a whistleblower administrative proceeding described in § 301.7623–3(c) and the expiration of the statutory period for filing a claim for refund by Taxpayer 2, the Whistleblower Office determines the amount of the award and communicates the award to the whistleblower in a determination letter. The whistleblower may appeal the notice to the Tax Court within 30 days.

(3) Joint Whistleblowers. If multiple whistleblowers jointly submit a claim for award, the IRS will pay any award in equal shares to the joint whistleblowers unless the joint whistleblowers specify a different allocation in a written agreement, signed by all the joint whistleblower...
ers and notarized, and submitted with the claim for award. The aggregate award payment in cases involving joint whistleblowers will be within the award percentage range of section 7623(b)(1) or section 7623(b)(2), as applicable, and subject to the award reduction provisions of section 7623(b)(3).

(4) Deceased Whistleblower. If a whistleblower dies before or during the whistleblower administrative proceeding, the Whistleblower Office may substitute an executor, administrator, or other legal representative on behalf of the deceased whistleblower for purposes of conducting the whistleblower administrative proceeding.

(5) Tax treatment of award. All awards are includible in gross income and subject to current Federal tax reporting and withholding requirements.

(e) Effective/applicability date. This rule is effective on August 12, 2014. This rule applies to information submitted on or after August 12, 2014, and to claims for award under section 7623(b) that are open as of August 12, 2014.

John Dalrymple,
Deputy Commissioner for Services and Enforcement.

Approved: July 20, 2014

Mark J. Mazur,
Assistant Secretary of the Treasury (Tax Policy).

(Filed by the Office of the Federal Register on August 7, 2014, 11:15 a.m., and published in the issue of the Federal Register for August 12, 2014, 79 F.R. 47246)
Clarification and Modification of Notice 2013–29 and Notice 2013–60

Notice 2014–46

SECTION 1. PURPOSE

On January 2, 2013, the American Taxpayer Relief Act of 2012, Pub. L. No. 112–240, 126 Stat. 2313 (ATRA), modified the definition of certain qualified facilities under section 45(d) of the Internal Revenue Code (the Code) by replacing the placed in service requirement with a beginning of construction requirement. Accordingly, a taxpayer will be eligible to receive the renewable electricity production tax credit (PTC) under section 45, or the energy investment tax credit (ITC) under section 48 in lieu of the PTC, with respect to such a facility if construction of such facility began before January 1, 2014.

Notice 2013–29, 2013–1 C.B. 1085, provides two methods to determine when construction has begun on a qualified facility: (i) a “physical work” test and (ii) a five percent safe harbor. Notice 2013–60, 2013–2 C.B. 431, clarifies Notice 2013–29 regarding (i) the determination of whether a taxpayer satisfies either the continuous construction requirement or the continuous efforts requirement of those methods with respect to a facility, (ii) the applicability of the “master contract” provision, and (iii) the ability to transfer a facility after construction has begun. This notice further clarifies Notices 2013–29 and 2013–60 regarding (i) how to satisfy the physical work test and (ii) the effect of various types of transfers with respect to a facility after construction has begun. In addition, this notice modifies the application of the five percent safe harbor.

The guidance provided in this notice applies the rules of sections 45 and 48 as in effect on January 1, 2014. The Internal Revenue Service (Service) will not issue private letter rulings to taxpayers regarding the application of this notice or the application of the beginning of construction requirement under sections 45(d) and 48(a)(5) as provided in Notice 2013–29 and Notice 2013–60.

SECTION 2. BACKGROUND

A taxpayer may establish the beginning of construction by beginning physical work of a significant nature as described in section 4 of Notice 2013–29 (Physical Work Test). Alternatively, a taxpayer may establish the beginning of construction by meeting the safe harbor provided in section 5 of Notice 2013–29 (Safe Harbor). A taxpayer can satisfy the Safe Harbor with respect to a facility by demonstrating, after the facility is placed in service, that five percent or more of the total cost of the facility was paid or incurred before January 1, 2014. Both methods require that a taxpayer make continuous progress towards completion once construction has begun (as set forth in section 4.06 (Continuous Construction Test) and section 5.02 (Continuous Efforts Test) of Notice 2013–29, respectively).

In response to a significant number of questions received after the publication of Notice 2013–29, the Treasury Department and the Service issued Notice 2013–60, which in part clarifies that the transfer of a facility after construction has begun will not necessarily prevent a facility from qualifying for the PTC or the ITC. Additionally, section 3.02 of Notice 2013–60 provides a method for taxpayers to satisfy either the Continuous Construction Test or the Continuous Efforts Test. If a taxpayer places a facility in service before January 1, 2016, the facility will be considered to satisfy the Continuous Construction Test (for purposes of satisfying the Physical Work Test) or the Continuous Efforts Test (for purposes of satisfying the Safe Harbor), regardless of the amount of physical work performed or the amount of costs paid or incurred with respect to the facility between December 31, 2013, and January 1, 2016.

After the publication of Notice 2013–60, the Treasury Department and the Service received requests for further clarification regarding how to satisfy the Physical Work Test as well as questions regarding the effect of various types of transfers with respect to a facility after construction has begun. This notice clarifies the application of the Physical Work Test and the effect that certain transfers with respect to a facility after construction has begun will have on a taxpayer’s ability to qualify for the PTC or the ITC. In addition, this notice modifies the application of the Safe Harbor for certain facilities with respect to which a taxpayer paid or incurred less than five percent, but at least three percent, of the total cost of the facility before January 1, 2014.

SECTION 3. PHYSICAL WORK TEST

The Physical Work Test requires that a taxpayer begin physical work of a significant nature (as defined in section 4.02 of Notice 2013–29) prior to January 1, 2014. This test focuses on the nature of the work performed, not the amount or cost. Notice 2013–29 describes several activities that constitute physical work of a significant nature. These activities are merely examples and not an exclusive list of the activities that will satisfy the Physical Work Test. For example, section 4.02 of Notice 2013–29 provides:

In the case of a facility for the production of electricity from a wind turbine, on-site physical work of a significant nature begins with the beginning of the excavation for the foundation, the setting of anchor bolts into the ground, or the pouring of the concrete pads of the foundation.

Section 4.05(1) of Notice 2013–29 provides: Physical work on a custom-designed transformer that steps up the voltage of electricity produced at the facility to the voltage needed for transmission is physical work of a significant nature with respect to the facility because power conditioning equipment is an integral part of the activity performed by the facility.

Section 4.05(2) of Notice 2013–29 provides: Roads that are integral to the facility are integral to the activity performed by the facility; these include onsite roads that are used for moving materials to be processed (for example, biomass) and roads for equipment to operate and maintain the qualified facility. Starting construction on these roads constitutes physical work of a significant nature with respect to the facility.

Beginning work on any one of the activities described above will constitute physical work of a significant nature.
Section 4.04(3) of Notice 2013–29 provides an example in which X, a developer of a 50 turbine wind farm, is found to satisfy the beginning of construction requirement in part based on the stated fact that, in 2013, for 10 of the 50 turbines, X excavates the site for the foundations of the wind turbines and pours concrete for the supporting pads. This example illustrates the “single project” concept set forth in section 4.04(2) of Notice 2013–29 and is not intended to indicate that there is a 20% threshold or minimum amount of work required to satisfy the Physical Work Test.

Assuming the work performed is of a significant nature, there is no fixed minimum amount of work or monetary or percentage threshold required to satisfy the Physical Work Test.

As provided in section 4.01 of Notice 2013–29 the Service will closely scrutinize a facility, and may determine that construction has not begun on a facility before January 1, 2014, if a taxpayer does not maintain a continuous program of construction as determined under section 4.06 of Notice 2013–29 and section 3.02 of Notice 2013–60.

SECTION 4. TRANSFERS WITH RESPECT TO A FACILITY

01 In general. Certain of the definitions of a qualified facility provided in section 45(d) require that the construction of the facility begin before January 1, 2014. There is no statutory requirement that the taxpayer that places the facility in service also be the taxpayer that begins construction of the facility. See Notice 2013–60, section 5.01. Moreover, section 48(a)(5)(D) defines “qualified property” (which may be eligible for the ITC in lieu of the PTC) as certain property that is “constructed, reconstructed, erected, or acquired by the taxpayer.” (Emphasis added.) Thus, except as provided in section 4.03 of this notice, a fully or partially developed facility may be transferred without losing its qualification under the Physical Work Test or the Safe Harbor for purposes of the PTC or the ITC. For example, a taxpayer may acquire a facility (that consists of more than just tangible personal property) from an unrelated developer that had begun construction of the facility prior to January 1, 2014, and thereafter the taxpayer may complete the development of that facility and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by the unrelated transferor developer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or Safe Harbor.

02 Relocation of equipment by a taxpayer. A taxpayer also may begin construction of a facility in 2013 with the intent to develop the facility at a certain site, but thereafter transfer equipment and other components of the facility to a different site, complete its development, and place it in service. The work performed or amount paid or incurred prior to January 1, 2014, by such a taxpayer may be taken into account for purposes of determining whether the facility satisfies the Physical Work Test or the Safe Harbor.

03 Transfers of equipment between unrelated parties. In the case of a transfer consisting solely of tangible personal property (including contractual rights to such property under a binding written contract) to a transferee not related (defined for these purposes by reference to section 197(f)(9)(C)) to the transferor, any work performed or amount paid or incurred by the transferee with respect to such property so transferred will not be taken into account with respect to the transferee for purposes of the Physical Work Test or the Safe Harbor.

Example. Developer D intends to develop and operate Facility K at a location to be determined. Prior to January 1, 2014, Developer D pays or incurs $60,000 to have tangible personal property integral to Facility K manufactured off-site pursuant to a binding written contract. Thereafter Developer D incurs no further development costs and engages in no further development activity with respect to Facility K. In January 2014, Developer D sells the tangible personal property to Developer E, a party unrelated to Developer D. Developer E is developing and intends to operate Facility L, a facility located on a parcel of land owned by Developer E. Developer E incorporates the tangible personal property acquired from Developer D into Facility L. In October 2015, Developer E places Facility L in service on the parcel of land. The total cost of Facility L is $1,000,000.

Amounts paid or incurred by Developer D prior to January 1, 2014, for the tangible personal property will not be taken into account for purposes of satisfying the Safe Harbor with respect to Facility L. However, if without regard to these components, Developer E has otherwise satisfied the Physical Work Test or the Safe Harbor with respect to Facility L, Developer E will be eligible to claim the PTC with respect to electricity generated by Facility L and sold to an unrelated party. In such a case, Developer E may alternatively elect to claim the ITC in lieu of the PTC.

SECTION 5. SAFE HARBOR

01 Single project. If the amount a taxpayer paid or incurred before January 1, 2014, with respect to the total cost of a facility that is a single project comprised of multiple facilities (as described in section 4.04(2) of Notice 2013–29) is less than five percent of the total cost of the facility at the time the facility is placed in service, the Safe Harbor is not fully satisfied. However, if a taxpayer paid or incurred at least three percent of the total cost of such a facility before January 1, 2014, the Safe Harbor may be satisfied and the PTC or ITC may be claimed with respect to some, but not all, of the individual facilities (as described in section 4.04(1) of Notice 2013–29) comprising the project. In this situation, a taxpayer may claim the PTC or ITC on any number of individual facilities as long as the total aggregate cost of those individual facilities at the time the project is placed in service is not greater than twenty times the amount the taxpayer paid or incurred before January 1, 2014. The Continuous Efforts Test of section 5.02 of Notice 2013–29 must also be met to qualify for the Safe Harbor.

02 Single facility. If the amount a taxpayer actually paid or incurred before January 1, 2014, with respect to the total cost of a single facility that is not a single project comprised of multiple individual facilities (as described in section 4.04(2) of Notice 2013–29), and that cannot be separated into individual facilities, is less than five percent of the total cost of the facility at the time the facility is placed in service, then the taxpayer will not satisfy the Safe Harbor with respect to any portion of the facility.

03 Examples – (a) Example 1. Developer incurs $30,000 in costs prior to January 1, 2014, to construct Project M, a five-turbine wind farm, that will be operated as a single project (as described in section 4.04(2) of Notice 2013–29). In October 2015, Developer places Project M in service. The total cost of Project M is $800,000, with each turbine costing $160,000. Although Developer did not pay or incur five percent of the total cost of Project M before January 1, 2014, Developer paid or incurred at least three percent of the total cost of Project M before January 1, 2014. In addition, because Devel-
Section 6. EFFECT ON OTHER DOCUMENTS


Section 7. DRAFTING INFORMATION

The principal author of this notice is Jennifer C. Bernardini of the Office of Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice contact Ms. Bernardini on (202) 317-6853 (not a toll-free number).

Health Insurance Providers Fee

Notice 2014–47

Section 1. PURPOSE

This notice provides guidance for the 2014 fee year on how the Internal Revenue Service (IRS) and the Department of Treasury (Treasury) will administer the definition of a covered entity for purposes of the fee imposed by § 9010 of the Patient Protection and Affordable Care Act (PPACA), Public Law 111–148 (124 Stat. 119 (2010)), as amended by § 10905 of PPACA, and as further amended by § 1406 of the Health Care and Education Reconciliation Act of 2010, Public Law 111–152 (124 Stat. 1029 (2010)) (collectively, the ACA). This notice applies only to the 2014 fee year. All references to § 9010 are references to § 9010 of the ACA.

Section 2. BACKGROUND

Section 9010(c)(1) defines the term “covered entity” to mean any entity that provides health insurance for any United States health risk during the calendar year in which the fee is due (the fee year).

Generally, § 9010(c)(2) excludes from the definition of covered entity—(A) self-insured employers; (B) governmental entities; (C) certain nonprofit corporations; and (D) non-employer established § 501(c)(9) entities.

Section 9010(c)(3) provides that for purposes of § 9010(c), all persons treated as a single employer under subsection (a) or (b) of § 52 of the Internal Revenue Code (Code), or subsection (m) or (o) of § 414 shall be treated as a single covered entity (or employer for purposes of § 9010(c)(2)).

Section 57.2(c)(1) of the Health Insurance Providers Fee Regulations (Regulations) defines the term “controlled group” to mean a group of two or more persons, including at least one person that is a covered entity, that is treated as a single employer under § 52(a), 52(b), 414(m), or 414(o) of the Code.

Section 57.2(c)(2) of the Regulations treats a controlled group (as defined in § 57.2(c)(1)) as a single covered entity for purposes of the health insurance providers fee.

Section 57.2(d) defines the term data year to mean the calendar year immediately before the fee year.

Section 57.2(g) defines the term fee year to mean the calendar year in which the fee must be paid to the government.

Section 3. DISCUSSION

For the 2014 fee year, the IRS and Treasury will not treat any entity as a covered entity if it is excluded from the definition of a covered entity because it qualifies for one of the exclusions under § 9010(c)(2) for the entire 2013 data year or qualifies for one of the exclusions under § 9010(c)(2) for the entire 2014 fee year, which began on January 1, 2014. Since the IRS and Treasury will not treat such an entity as a covered entity, it should not report its net premiums written for the 2013 data year.

In addition, for the 2014 fee year, a controlled group must report net premiums written only for those persons who are controlled group members at the end of the day on December 31 of the 2013 data year and who would qualify as a covered entity in the fee year if it were a single-person covered entity. A controlled group should not report net premiums written for any controlled group member who would not qualify as a covered entity in the 2014 fee year if it were a single-person covered entity.

Such entity will be treated as a member of the controlled group for other purposes, however, such as joint and several liability for the fee amount allocated to the controlled group. Additional guidance will be issued in the future regarding the scope of the exclusions in § 9010(c)(2) from the general definition of the term covered entity for years after the 2014 fee year.

Section 4. CORRECTIVE ACTIONS/APPLICABILITY

Any entity that needs to correct a previously submitted Form 8963, “Report of Health Insurance Provider Information,” due to the clarification provided in this notice must do so by faxing the corrected Form 8963 to 877-797-0235 (a toll-free number) no later than Monday, August 18, 2014. The IRS cannot process a Form 8963 received after this date. This notice applies only to the 2014 fee year.
Bulletin No. 2014–36

The IRS and Treasury recognize that entities will not know whether they qualify for one of the exclusions under § 9010(c)(2) for the entire 2014 fee year until the end of 2014. Entities that reasonably project that they will qualify for an exclusion under § 9010(c)(2) for the entire 2014 fee year may submit a corrected Form 8963 on or before August 18, 2014, even though the 2014 fee year is not yet over.

Section 5. DRAFTING INFORMATION

The principal author of this notice is Natalie Payne of the Office of the Associate Chief Counsel (Passthroughs & Special Industries). For further information regarding this notice please contact Ms. Payne at (202) 317-6855 (not a toll-free number).

Update for Weighted Average Interest Rates, Yield Curves, and Segment Rates

Notice 2014–48

This notice provides guidance on the corporate bond monthly yield curve, the corresponding spot segment rates used under § 417(e)(3), and the 24-month average segment rates under § 430(h)(2) of the Internal Revenue Code. In addition, this notice provides guidance as to the interest rate on 30-year Treasury weighted average rate under § 431(c)(6)(E)(ii)(I). The rates in this notice reflect the application of § 430(h)(2)(C)(iv), which was added by section 2003 of the Highway and Transportation Funding Act of 2014 (HATFA).

YIELD CURVE AND SEGMENT RATES

Generally, except for certain plans under sections 104 and 105 of the Pension Protection Act of 2006 and CSEC plans under § 414(y), § 430 of the Code specifies the minimum funding requirements that apply to single-employer plans pursuant to § 412. Section 430(h)(2) specifies the interest rates that must be used to determine a plan’s target normal cost and funding target. Under this provision, present value is generally determined using three 24-month average interest rates (“segment rates”), each of which applies to cash flows during specified periods. To the extent provided under § 430(h)(2)(C)(iv), these segment rates are adjusted by the applicable percentage of the 25-year average segment rates for the period ending September 30 of the year preceding the calendar year in which the plan year begins. However, an election may be made under § 430(h)(2)(D)(ii) to use the monthly yield curve in place of the segment rates.

Notice 2007–81, 2007–44 I.R.B. 899, provides guidelines for determining the monthly corporate bond yield curve, and the 24-month average corporate bond segment rates used to compute the target normal cost and the funding target. In accordance with the methodology specified in Notice 2007–81, the monthly corporate bond yield curve derived from July 2014 data is in Table I at the end of this notice. The spot first, second, and third segment rates for the month of July 2014 are, respectively, 1.26, 3.94, and 5.02.

The 24-month average segment rates determined under § 430(h)(2)(C)(ii) through (iii) must be adjusted pursuant to § 430(h)(2)(C)(iv) by the applicable percentage of the corresponding 25-year average segment rates. Section 2003(a) of HATFA amended the applicable percentages under § 430(h)(2)(C)(iv). This change generally applies to plan years beginning on or after January 1, 2013. However, pursuant to section 2003(e)(2) of HATFA, a plan sponsor can elect not to have the amendments made to the applicable percentages by section 2003 of HATFA apply to any plan year beginning in 2013. These elections can be made either for all purposes or, alternatively, for purposes of determining the adjusted funding target attainment percentage under § 436. The 25-year average segment rates for plan years beginning in 2012, 2013, and 2014 were published in Notice 2012–55, 2012–36 I.R.B. 332, Notice 2013–11, 2013–11 I.R.B. 610, and Notice 2013–58, 2013–40 I.R.B. 294, respectively.

For plan years beginning in years 2012 through 2017, pursuant to the changes made by HATFA, the applicable minimum percentage is 90% and the applicable maximum percentage is 110%. These applicable percentages are referred to as HATFA applicable percentages. As described in the preceding paragraph, a special election is available for any plan year beginning in 2013 under which this change made by HATFA can be disregarded for all purposes or for limited purposes. To the extent such an election is made, the applicable minimum percentage for a plan year beginning in 2013 is 85% and the applicable maximum percentage for that plan year is 115%. These applicable percentages are referred to as MAP–21 applicable percentages.

The 25-year segment rates and permissible corridors for plan years beginning in 2013 are as follows:

<table>
<thead>
<tr>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>25-year average rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Min</td>
<td>5.81</td>
<td>7.23</td>
</tr>
<tr>
<td>Max</td>
<td>6.39</td>
<td>7.95</td>
</tr>
<tr>
<td>HATFA Permissible corridors</td>
<td>to</td>
<td>to</td>
</tr>
<tr>
<td>Min</td>
<td>4.94</td>
<td>6.15</td>
</tr>
<tr>
<td>Max</td>
<td>6.68</td>
<td>8.31</td>
</tr>
<tr>
<td>MAP–21 Permissible corridors for electing plans</td>
<td>to</td>
<td>to</td>
</tr>
</tbody>
</table>

This notice provides guidance on determining the present value of corporate bond cash flows.
The 25-year segment rates and HATFA permissible corridors for plan years beginning in 2014 are as follows:

<table>
<thead>
<tr>
<th></th>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>25-year average rates</td>
<td>5.54</td>
<td>7.02</td>
<td>7.77</td>
</tr>
<tr>
<td>Min</td>
<td>4.99</td>
<td>6.32</td>
<td>6.99</td>
</tr>
<tr>
<td>HATFA Permissible corridors</td>
<td>to</td>
<td>to</td>
<td>to</td>
</tr>
<tr>
<td>Max</td>
<td>6.09</td>
<td>7.72</td>
<td>8.55</td>
</tr>
</tbody>
</table>

The three 24-month average corporate bond segment rates applicable for August 2014 without adjustment for the 25-year average segment rate limits are as follows:

<table>
<thead>
<tr>
<th>Applicable Month</th>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>August 2014</td>
<td>1.15</td>
<td>4.06</td>
<td>5.14</td>
</tr>
</tbody>
</table>

Based on § 430(h)(2)(C)(iv) as in effect prior to amendment by section 2003 of HATFA, the three 24-month averages applicable for August 2014 adjusted for the MAP–21 applicable percentages of the corresponding 25-year average segment rates, for plan years beginning in 2013, are as follows:

<table>
<thead>
<tr>
<th>For Plan Years Beginning In</th>
<th>Adjusted 24-Month Average Segment Rates, Based on Applicable Percentage of 25-Year Average Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Applicable Month</td>
</tr>
<tr>
<td>2013 August</td>
<td>2014</td>
</tr>
</tbody>
</table>

Based on § 430(h)(2)(C)(iv) as amended by section 2003 of HATFA, the 24-month averages applicable for August 2014 adjusted for the HATFA applicable percentages of the corresponding 25-year average segment rates, are as follows:

<table>
<thead>
<tr>
<th>For Plan Years Beginning In</th>
<th>Adjusted 24-Month Average Segment Rates, Based on the HATFA Applicable Percentage of 25-Year Average Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Applicable Month</td>
</tr>
<tr>
<td>2013 August</td>
<td>2014</td>
</tr>
</tbody>
</table>

For all prior applicable months with respect to plan years beginning in 2013¹, and for all prior applicable months with respect to plan years beginning in 2014, the unadjusted 24-month average segment rates have been lower than the minimum permissible values under the applicable percentages as modified by HATFA. Therefore, with respect to plan years beginning in 2013, for applicable months September 2012 through July 2014, the first, second, and third adjusted 24-month average segment rates determined under the applicable percentages as modified by HATFA are equal to the adjusted segment rates for the August 2014 applicable month that are listed in the table immediately above for plan years beginning in 2013. Similarly, with respect to plan years beginning in 2014, for applicable months September 2013 through July 2014, the

¹As provided under § 430(h)(2)(E), for purposes of determining interest rates for a plan year, the applicable month with respect to plan years beginning in 2013 may be as early as September 2012.
first, second, and third adjusted 24-month average segment rates determined under the applicable percentages as modified by HATFA are equal to the adjusted segment rates for the August 2014 applicable month that are listed in the table immediately above for plan years beginning in 2014. The adjusted segment rates published in prior notices for these applicable months for plan years beginning in 2014 do not apply, and the adjusted segment rates published in prior notices for these applicable months for plan years beginning in 2013 apply only to the extent applicable under an election, pursuant to section 2003(e)(2) of HATFA, to apply the MAP–21 segment rates rather than the HATFA segment rates. For a list of affected notices, see the section entitled Effect On Other Documents, below.

30-YEAR TREASURY SECURITIES INTEREST RATES

Generally, for plan years beginning after 2007, § 431 specifies the minimum funding requirements that apply to multiemployer plans pursuant to § 412. Section 431(c)(6)(B) specifies a minimum amount for the full-funding limitation described in section 431(c)(6)(A), based on the plan’s current liability. Section 431(c)(6)(E)(ii)(I) provides that the interest rate used to calculate current liability for this purpose must be no more than 5 percent above and no more than 10 percent below the weighted average of the rates of interest on 30-year Treasury securities during the four-year period ending on the last day before the beginning of the plan year. Notice 88–73, 1988–2 C.B. 383, provides guidelines for determining the weighted average interest rate. The rate of interest on 30-year Treasury securities for July 2014 is 3.33 percent. The Service has determined this rate as the average of the daily determinations of yield on the 30-year Treasury bond maturing in May 2044. The following rates were determined for plan years beginning in the month shown below.

<table>
<thead>
<tr>
<th>For Plan Years Beginning in</th>
<th>30-Year Treasury Weighted Average</th>
<th>Permissible Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Month</td>
<td>Year</td>
<td>90%</td>
</tr>
<tr>
<td>August</td>
<td>2014</td>
<td>3.41</td>
</tr>
</tbody>
</table>

MINIMUM PRESENT VALUE SEGMENT RATES

In general, the applicable interest rates under § 417(e)(3) are segment rates computed without regard to a 24-month average or adjustments based on a 25-year average. Notice 2007–81 provides guidelines for determining the minimum present value segment rates. Pursuant to that notice, the minimum present value segment rates determined for July 2014 are as follows:

<table>
<thead>
<tr>
<th>First Segment</th>
<th>Second Segment</th>
<th>Third Segment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.26</td>
<td>3.94</td>
<td>5.02</td>
</tr>
</tbody>
</table>

FUTURE GUIDANCE

The Treasury and the Service intend to issue additional guidance in the near future on other issues relating to the application of HATFA, including guidance relating to benefit restrictions, elections, and transition issues.

EFFECT ON OTHER DOCUMENTS


DRAFTING INFORMATION

The principal author of this notice is Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. However, other personnel from the Internal Revenue Service and the Treasury Department participated in preparing this notice. Mr. Montanaro may be e-mailed at RetirementPlanQuestions@irs.gov.
<table>
<thead>
<tr>
<th>Maturity</th>
<th>Yield</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.5</td>
<td>0.18</td>
</tr>
<tr>
<td>1.0</td>
<td>0.43</td>
</tr>
<tr>
<td>1.5</td>
<td>0.68</td>
</tr>
<tr>
<td>2.0</td>
<td>0.93</td>
</tr>
<tr>
<td>2.5</td>
<td>1.17</td>
</tr>
<tr>
<td>3.0</td>
<td>1.41</td>
</tr>
<tr>
<td>3.5</td>
<td>1.64</td>
</tr>
<tr>
<td>4.0</td>
<td>1.86</td>
</tr>
<tr>
<td>4.5</td>
<td>2.07</td>
</tr>
<tr>
<td>5.0</td>
<td>2.27</td>
</tr>
<tr>
<td>5.5</td>
<td>2.46</td>
</tr>
<tr>
<td>6.0</td>
<td>2.64</td>
</tr>
<tr>
<td>6.5</td>
<td>2.81</td>
</tr>
<tr>
<td>7.0</td>
<td>2.96</td>
</tr>
<tr>
<td>7.5</td>
<td>3.11</td>
</tr>
<tr>
<td>8.0</td>
<td>3.25</td>
</tr>
<tr>
<td>8.5</td>
<td>3.38</td>
</tr>
<tr>
<td>9.0</td>
<td>3.50</td>
</tr>
<tr>
<td>9.5</td>
<td>3.61</td>
</tr>
<tr>
<td>10.0</td>
<td>3.71</td>
</tr>
<tr>
<td>10.5</td>
<td>3.81</td>
</tr>
<tr>
<td>11.0</td>
<td>3.90</td>
</tr>
<tr>
<td>11.5</td>
<td>3.98</td>
</tr>
<tr>
<td>12.0</td>
<td>4.05</td>
</tr>
<tr>
<td>12.5</td>
<td>4.12</td>
</tr>
<tr>
<td>13.0</td>
<td>4.18</td>
</tr>
<tr>
<td>13.5</td>
<td>4.23</td>
</tr>
<tr>
<td>14.0</td>
<td>4.29</td>
</tr>
<tr>
<td>14.5</td>
<td>4.33</td>
</tr>
<tr>
<td>15.0</td>
<td>4.38</td>
</tr>
<tr>
<td>15.5</td>
<td>4.41</td>
</tr>
<tr>
<td>16.0</td>
<td>4.45</td>
</tr>
<tr>
<td>16.5</td>
<td>4.48</td>
</tr>
<tr>
<td>17.0</td>
<td>4.51</td>
</tr>
<tr>
<td>17.5</td>
<td>4.54</td>
</tr>
<tr>
<td>18.0</td>
<td>4.57</td>
</tr>
<tr>
<td>18.5</td>
<td>4.59</td>
</tr>
<tr>
<td>19.0</td>
<td>4.61</td>
</tr>
<tr>
<td>19.5</td>
<td>4.64</td>
</tr>
<tr>
<td>20.0</td>
<td>4.66</td>
</tr>
</tbody>
</table>

Table I
Monthly Yield Curve for July 2014
Derived from July 2014 Data

SECTION 1. PURPOSE

This revenue procedure provides the exclusive procedures by which a taxpayer obtains the consent of the Commissioner under § 446(e) of the Internal Revenue Code to make certain changes within the retail inventory method to comply with final regulations under § 1.471–8 of the Income Tax Regulations.

SECTION 2. BACKGROUND

.01 Under § 1.471–8, a taxpayer may use the retail inventory method to compute the value of ending inventory at approximate cost (retail cost) or approximate lower of cost or market (retail LCM), by multiplying the retail selling prices of goods on hand at the end of the taxable year by a cost complement ratio. The cost complement is the value of beginning inventory plus the cost of purchases divided by the retail selling prices of beginning inventory and purchases. On August 15, 2014, the Internal Revenue Service (IRS) and Treasury Department published final regulations under § 1.471–8 (TD 9688) clarifying a taxpayer’s treatment of certain sales-based vendor allowances, margin protection payments, permanent markups and markdowns, and temporary markups and markdowns when determining the cost complement. The final regulations apply to taxable years beginning after December 31, 2014.

.02 The final regulations clarify that a taxpayer using the retail inventory method may not reduce the numerator of the cost complement by the amount of an allowance, discount, or price rebate that, under § 1.471–3(e), must reduce only cost of goods sold.

.03 The final regulations provide that a taxpayer using retail LCM generally may not reduce the numerator of the cost complement by the amount of an allowance, discount, or price rebate that is related to or intended to compensate for a reduction in the taxpayer’s retail selling price of inventory (a margin protection payment).

.04 The final regulations clarify that a taxpayer using the retail inventory method generally must adjust the denominator of the cost complement for all permanent markups and markdowns, but may not reduce the denominator for temporary markups or markdowns. A taxpayer using retail LCM, however, generally does not adjust the denominator of the cost complement for markdowns.

.05 The final regulations provide an alternative method for a taxpayer using retail LCM to compute the cost complement by reducing the numerator by the amount of margin protection payments if the taxpayer also reduces the denominator of the cost complement by the amount of the reductions in retail selling price to which the margin protection payments relate (related markdowns).

.06 The final regulations provide a second alternative method for a taxpayer using retail LCM to account for margin protection payments when computing the cost complement. Under this method, a taxpayer that is able to determine the amount of its margin protection payments but cannot determine the amount of the related markdowns may compute the cost complement by reducing the numerator by the amount of margin protection payments and adjusting the denominator by the amount that, in conjunction with the reduction of the numerator, maintains what would have been the cost complement percentage before taking into account the margin protection payments and related markdowns.

.07 A taxpayer using one of the alternative methods described in sections 2.05 and 2.06 above must use that method for all cost complements.

.08 Sections 446(e) and 1.446–1(e)(2) state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446–1(e)(3)(i) authorizes the Commissioner to prescribe administrative procedures providing the limitations, terms, and conditions necessary to permit a taxpayer to obtain consent to change a method of accounting in accordance with § 446(e).


.10 Section 481(a) requires the adjustments necessary to prevent amounts from being duplicated or omitted when a taxpayer’s taxable income is determined under a method of accounting different from the method used to determine taxable income for the preceding taxable year. See section 2.05(1) of Rev. Proc. 2011–14.

.11 When a change in method of accounting is made on a cut-off basis, in general, only the items arising on or after the beginning of the year of change are accounted for under the new method of accounting. See section 2.06 of Rev. Proc. 2011–14.

SECTION 3. SCOPE

This revenue procedure applies to a taxpayer using the retail inventory method that wants to change its method of accounting to comply with the final regulations under § 1.471–8.

SECTION 4. CHANGES IN METHOD OF ACCOUNTING

Rev. Proc. 2011–14 is modified to add new section 21.16 of the APPENDIX, to read as follows:

.16 Retail inventory method.

(1) Description of change. This change applies to a taxpayer using the retail inventory method that wants to make one of the following changes—

(a) From adjusting to not adjusting the numerator of the cost complement by the amount of an allowance, discount, or price rebate that is required under § 1.471–3(e) to reduce only cost of goods sold;

(b) From adjusting to not adjusting the denominator of the cost complement for temporary markups and markdowns;

(c) In the case of a retail LCM taxpayer:

(i) From adjusting to not adjusting the numerator of the cost complement by the amount of a margin protection payment;

(ii) From adjusting to not adjusting the denominator of the cost complement for permanent markdowns;

(iii) From using one method for computing the cost complement described in § 1.471–8(b)(3) to using a different method described in § 1.471–8(b)(3);
(d) In the case of a retail cost taxpayer, from not adjusting to adjusting the denominator of the cost complement for permanent markups and markdowns;

(2) Certain scope limitations temporarily inapplicable. The scope limitations in section 4.02 (1) through (4) and (7) of this revenue procedure do not apply for a taxpayer’s first or second taxable years beginning after December 31, 2014.

(3) Multiple changes. A taxpayer that wants to make multiple changes under this section 21.16 of the APPENDIX for the same year of change should file a single Form 3115.

(4) Manner of making change. A taxpayer making a change under this section 21.16 of the APPENDIX for its first or second taxable year beginning after December 31, 2014 may use either a § 481(a) adjustment as provided in sections 5.03 and 5.04 of this revenue procedure or implement the change on a cut-off basis. If a cut-off basis is used, the change applies only to the computation of ending inventories after the beginning of the year of change. See section 2.06 of this revenue procedure for more information regarding a cut-off basis. A § 481(a) adjustment is neither permitted nor required if a change is made on a cut-off basis.

(5) Designated automatic accounting method change number. The designated automatic accounting method change number for changes in methods of accounting under section 21.16 of this APPENDIX is “204.” See section 6.02(4) of this revenue procedure.

(6) Ogden copy of Form 3115 required in lieu of national office copy. A taxpayer changing its method of accounting under this section 21.16 of the APPENDIX must file a signed copy of its completed Form 3115 with the IRS in Ogden, UT, in lieu of filing the national office copy, no earlier than the first day of the year of change and no later than the date the taxpayer files the original Form 3115 with its federal income tax return for the year of change. See sections 6.02(3)(a)(ii)(B) (providing the general rules) and 6.02(7)(b) (providing the mailing address) of this revenue procedure.

(7) Contact information. For further information regarding a change under this section, contact Natasha M. Mulleneaux at 202–317–7007 (not a toll-free call).

SECTION 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 2011–14 is modified to add new section 21.16 to the APPENDIX.

SECTION 6. EFFECTIVE DATE

This revenue procedure is effective for taxable years beginning after December 31, 2014.

SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Natasha M. Mulleneaux of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Christopher Call at (202) 317–7007 (not a toll-free number).
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.
Ct.—City.
COOP—Cooperative.
C.D.—Court Decision.
Ct.—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.

EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FX—Foreign corporation.
G.C.M.—Chief Counsel’s Memorandum.
G.E.—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
IR.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.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
X—Corporation.
Y—Corporation.
Z—Corporation.
Numerical Finding List

Bulletins 2014–27 through 2014–36

Announcements:
2014-29, 2014-35 I.R.B. 452

Notices:

Proposed Regulations:
REG-104579-13, 2014-33 I.R.B. 370
REG-120756-13, 2014-31 I.R.B. 252
REG-105067-14, 2014-34 I.R.B. 391
REG-110948-14, 22014-30 I.R.B. 239
REG-121542-14, 2014-28 I.R.B. 119
REG-107012-14, 2014-33 I.R.B. 371
REG-123286-14, 2014-33 I.R.B. 377
REG-209459-78, 2014-31 I.R.B. 253

Revenue Procedures:
2014-37, 2014-33 I.R.B. 363

Revenue Rulings:
2014-21, 2014-34 I.R.B. 381

Treasury Decisions—Continued:
9669, 2014-28 I.R.B. 103
9670, 2014-29 I.R.B. 121
9671, 2014-29 I.R.B. 124
9672, 2014-30 I.R.B. 196
9673, 2014-30 I.R.B. 212
9674, 2014-30 I.R.B. 225
9675, 2014-31 I.R.B. 242
9676, 2014-32 I.R.B. 260
9677, 2014-31 I.R.B. 241
9678, 2014-32 I.R.B. 262
9679, 2014-32 I.R.B. 267
9680, 2014-32 I.R.B. 254
9681, 2014-33 I.R.B. 340
9682, 2014-33 I.R.B. 342
9683, 2014-33 I.R.B. 330
9684, 2014-33 I.R.B. 345
9685, 2014-34 I.R.B. 379
9686, 2014-34 I.R.B. 382
9687, 2014-36 I.R.B. 486
9688, 2014-36 I.R.B. 482
9689, 2014-36 I.R.B. 456

1A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.
Finding List of Current Actions on Previously Published Items

Bulletins 2014–27 through 2014–36

Announcements:

2012-11

2013-11

2010-41

Revenue Procedures:

1981-38

93-37

1981-38

2000-12

2002-55

2003-64

2004-21

2005-77

2011-14

2012-38

Revenue Procedures—Continued:

2012-46

2014-4

2014-5

2014-8

2014-9

2014-10

2014-13

2014-13

Notices:

2013-11

2013-23

2013-28

2013-29

2013-29

2013-32

2013-37

Notices—Continued:

2013-51

2013-60

2013-60

2014-44

Treasury Decisions:

2005-47
Obsoleted by T.D. 9668 2014-27 I.R.B. 1

2010-51
Obsoleted by T.D. 9684 2014-33 I.R.B. 345

2010-71
Obsoleted by T.D. 9684 2014-33 I.R.B. 345

2011-6
Obsoleted by T.D. 9684 2014-33 I.R.B. 345

2011-9
Obsoleted by T.D. 9684 2014-33 I.R.B. 345

---

1A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2014–01 through 2014–26 is in Internal Revenue Bulletin 2014–26, dated June 30, 2014.
INDEX

Internal Revenue Bulletins 2014–27 through 2014–36

The abbreviation and number in parenthesis following the index entry refer to the specific item; numbers in roman and italic type following the parentheses refer to the Internal Revenue Bulletin in which the item may be found and the page number on which it appears.

Key to Abbreviations:
Ann Announcement
CD Court Decision
DO Delegation Order
EO Executive Order
PL Public Law
PTE Prohibited Transaction Exemption
RP Revenue Procedure
RR Revenue Ruling
SPR Statement of Procedural Rules
TC Tax Convention
TD Treasury Decision
TDO Treasury Department Order

ADMINISTRATIVE—Cont.

Substitute Forms Preparation for Certain Information Returns (RP 27) 27, 41
Substitute Forms Preparation for Certain Information Returns (RP 44) 32, 274
Truncated Taxpayer Identification Numbers (TD 9675) 31, 242

EMPLOYEE PLANS

Individual Retirement Account Rollover Limitations (REG–209459–78) 31, 253
Longevity Annuity Contracts (TD 9673) 30, 212
Proposed Regulations:
26 CFR 408, Individual Retirement Accounts (REG–209459–78) 31, 253

Regulations:
26 CFR 54.9815–2708, as amended (TD 9671) 29, 174
26 CFR 1.401(a)(9)–6, amended; 1.401(a)(9)–6, amended; 1.403(b)–6, amended; 1.408–8, amended; 1.408A–6, amended; 1.6047–2, added (TD 9673) 30, 212
Rules relating to 90 day waiting period limitation (TD 9671) 29, 124
Weighted average interest rates
Segment rates for June 2014 (Notice 41) 27, 97
Segment rates for July 2014 (Notice 43) 31, 249
Segment rates for August 2014 (Notice 48) 36, 523

EMPLOYMENT TAX

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121
Method of accounting for gains and losses on shares in certain money market funds; broker returns with respect to sales of shares in money market funds (REG–107012–14) 33, 371

Publications:
1223, General Rules and Specifications for Substitute Forms W–2c and W–3c (RP 29) 28, 105
4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941), and Schedule R (RP 26) 27, 26
Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

Regulations:
26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103
26 CFR 1.1361–4, amended; 1.1361–4T, removed; 31.3121(b)(3)–1, amended; 31.3121(b)(3)–1T, removed; 31.3127–1, added; 31.3127–1T, removed; 31.3306(c)(5)–1, amended; 31.3306(c)(5)–1T, removed; 301.7701–2, amended; 301.7701–2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121
26 CFR 1.446–7 added; 1.6045–1 amended; method of accounting for gains and losses on shares in certain money market funds; broker returns with respect to sales of shares in money market funds (REG–107012–14) 33, 371
ESTATE TAX

Section 2032A.—Valuation of Certain Farm, Etc., Real Property (RR 21) 34, 381

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

EXCISE TAX

Branded Prescription Drug Fee (REG–123286–14) 33, 377

Branded Prescription Drug Fee (TD 9684) 33, 345

Branded Prescription Drug Fee (Notice 42) 34, 387

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

Section 9010 of the ACA; health insurance providers fee (Notice 47) 36, 522

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

26 CFR 1.1361–4, amended; 1.1361–4T, removed; 31.3121(b)(3)–1, amended; 31.3121(b)(3)–1T, removed; 31.3127–1, added; 31.3127–1T, removed; 31.3306(c)(5)–1, amended; 31.3306(c)(5)–1T, removed; 301.7701–2, amended; 301.7701–2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

26 CFR 54.9815–2708, as amended (TD 9671) 29, 121

26 CFR 51.2(e)(3), amended; (REG–123286–14) 33, 377

Rules relating to 90 day waiting period limitation (TD 9671) 29, 121

EXEMPT ORGANIZATIONS

Streamlined Application for Recognition of Exemption Under Section 501(c)(3) (RP 2014–40) 30, 229

Streamlined process for 501(c)(3) recognition (REG–110948–14) 30, 239

Streamlined process for 501(c)(3) recognition (TD 9674) 30, 225

Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews. (TD 9669) 28, 103

GIFT TAX

Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103

Regulations:

26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews (REG–121542–14) (TD 9669) 28, 103

INCOME TAX

Accounting method change, retail inventory method (RP 48) 36, 527

AJCA—Section 6707 and the Penalty for Failure to Furnish Information Regarding Reportable Transactions by Material Advisors (TD 9686) 34, 382

Allocation and Apportionment of Interest Expense (TD 9676) 32, 260

Awards for Information Relating to Detecting Underpayments of Tax or Violations of the Internal Revenue Laws (TD 9687) 36, 486

Basis of indebtedness of S corporations to their shareholders (TD 9682) 33, 342

Credit for carbon dioxide Sequestration (Notice 40) 27, 100

Disciplinary actions involving attorneys, certified public accountants, enrolled agents, and enrolled actuaries, enrolled retirement plan agents, and appraisers (Ann 29) 35, 452

Disclosure to Census Bureau (REG–120756–13) 31, 252

Disclosure to Census Bureau (TD 9677) 31, 241

Dispositions of property subject to depreciation under section 168 (TD 9689) 36, 456

FFI Agreement for Participating FFI and Reporting Model 2 FFI (RP 38) 29, 132

Foreign Earned Income Exclusion (Ann 28) 34, 391

Foreign tax credit guidance under section 901 (m) (Notice 44) 32, 270

Foreign tax credit guidance under section 901 (m) (Notice 45) 34, 388

Information reporting by passport applicants (TD 9679) 32, 267

Investment:


Federal short-term, mid-term, and long-term rates for: August 2014 (RR 19) 32, 266

Money market funds and the wash sale rules (RP 45) 34, 388

Premium Tax Credit (REG–104579–13) 33, 370

Premium Tax Credit (RP 37) 33, 363

Premium Tax Credit (RP 41) 33, 364

Premium Tax Credit (TD 9683) 33, 330

Production Tax Credit, Investment Tax Credit, Beginning of Construction (Notice 46) 36, 520

Proposed Regulations:

26 CFR part 301 is amended, section 301.6103(j)(1)–1 is amended, section 301.6103(j)(1)–1T added (REG–120756–13) 31, 252

26 C.F.R. 1.382–3(j)(17), modified; 1.382–3T(j)(17), added, segregation rules for public groups of shareholders (REG–105067–14) 34, 391

Publications:

1223, General Rules and Specifications for Substitute Forms W–2c and W–3c (RP 29) 28, 105

4436, General Rules and Specifications for Substitute Form 941 and Schedule B (Form 941), and Schedule R (RP 26) 27, 26

Qualified Intermediary (QI) Agreement (RP 39) 29, 151

Bulletin No. 2014–36

September 2, 2014
INCOME TAX—Cont.

Regulations:
31 CFR 10.1, revised; 10.3, revised; 10.22, revised; 10.31, revised; 10.35, revised; 10.36, revised; 10.37, revised; 10.52, revised; 10.81, revised; 10.82, revised; 10.91, revised (TD 9668) 27, 1
26 CFR 301.7602–1 is amended to add new paragraph (b)(3) pertaining to summons interviews (REG–121542–14) (TD 9669) 28, 103
26 CFR 1.45R–0, added; 1.45R–1, added; 1.45R–2, added; 1.45R–3, added; 1.45R–4, added; 1.45R–5, added; tax credit for employee health insurance expenses of small employers (TD 9672) 30, 196
26 CFR 301.6109–4, added; 1.6042–4, amended; 1.6043–4, amended; 1.6045–5, amended; 1.6045–2, amended; 1.6045–5, amended; 1.6049–6, amended; 1.6050A–1, amended; 1.6050E–1, amended; 1.6050N–1, amended; 1.6050P–1, amended; 1.6050S–1, amended; 1.6050S–3, amended (TD 9675) 31, 242
26 CFR 1.67–4, amended (TD 9667) 32, 254
26 CFR part 301 is amended, section 301.6103(j)(1)–1 is amended, section 301.6103(j)(1)–1T added (TD 9677) 31, 241
26 CFR 1.861–9, amended; 1.861–11, amended (TD 9676) 32, 260
26 CFR 1.1092(b)–6, added; 1.1092(b)–6T, removed; 1.1092(b)–3T, amended; (TD 9678) 32, 262
26 CFR part 301, added; 26 CFR 301.6039E–1 added (TD 9679) 32, 267
26 CFR 1.174–2, amended; (TD 9680) 32, 254
26 CFR 1.36B–2T, 26 CFR 1.36B–3T, 1.36B–4T, added; 26 CFR 1.36B–2, 26 CFR 1.36B–3, 1.36B–4, amended; 26 CFR 1.162(l)–1 and 26 CFR 1.162(l)–1T, added. (REG–104579–13) 33, 370
26 CFR 1.195–2, added; 26 CFR 1.708–1, amended; 26 CFR 1.709–1, amended. (TD 9681) 33, 340
26 CFR 1.1136–2(a), added new paragraph (a)(2) and moved current (a)(2) through (a)(6) to (a)(3) through (a)(7), respectively; basis of indebtedness of S corporations to their shareholders (TD 9682) 33, 342
26 CFR 1.36B–2T, 26 CFR 1.36B–3T, 1.36B–4T added, 26 CFR 1.36B–2, 26 CFR 1.36B–3, 1.36B–4, amended, 26 CFR 1.162(l)–1 and 26 CFR 1.162(l)–1T added, (TD 9683) 33, 330
26 CFR 1.382–3(j)(17), modified; 1.382–3T(j)(17), added, segregation rules for public groups of shareholders (TD 9685) 34, 379
26 CFR 301.6707–1, added; 301.6707–1T, removed; Rev. Proc. 2007–21, sections 4.04, 4.05, and 4.06 superseded; material advisor penalty for failure to furnish information regarding reportable transactions (TD 9686) 34, 382
26 CFR 301.7623–1, revised; 26 CFR 301.7623–4, added; 26 CFR 301.7623–2, added; 26 CFR 301.6103(h)(4)–1, added 26 CFR 301.7623–3, added; (TD 9687) 36, 486
26 CFR 1.471–8 amended (TD 9688) 36, 482
26 CFR 1.116(i)–8 added; 1.165–2, 1.168(i)–0, 1.168(i)–1, 1.168(i)–7, 1.263(a)–3, 1.1016–3 amended; 1.168(i)–0T, 1.168(i)–1T, 1.168(i)–8T removed; dispositions of property subject to depreciation under section 168 (TD 9689) 36, 456

INCOME TAX—Cont.

Regulations Governing Practice Before the Internal Revenue Service (REG–138367–06) (TD 9668) 27, 1
Research and experimental expenditures (TD 9680) 32, 254
Retail inventory method (TD 9688) 36, 482
Tax Credit for Employee Health Insurance Expenses of Small Employers (TD 9672) 30, 196
Truncated Taxpayer Identification Numbers (TD 9675) 31, 242
Section 67 Limitations on Estates or Trusts; Change of Effective Date (TD 9664) 32, 254
Section 5000A national average premium for a bronze level of coverage (RP 46) 33, 367
Segregation rules for public groups of shareholders, (REG–105067–14) 34, 391
Segregation rules for public groups of shareholders, (TD 9685) 34, 379
Substitute Forms Preparation for Certain Information Returns (RP 27) 27, 41
Substitute Forms Preparation for Certain Information Returns (RP 44) 32, 274
Summons Interview Regulations Under Section 7602 (REG–121542–14) (TD 9669) 28, 103
Unamortized organization and syndication expenses following a partnership technical termination (TD 9681) 33, 340
Underpayment and overpayments, quarter beginning: July 1, 2014 (RR 14) 27, 12
Unrealized gain or loss treatment upon establishment of an identified mixed straddle (TD 9678) 32, 262
Withholding Foreign Partnership and Trust Agreements (RP 47) 35, 393

SELF-EMPLOYMENT TAX

Extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

Regulations:
26 CFR 1.1361–4, amended; 1.1361–4T, removed; 31.3121(b)(3)–1, amended; 31.3121(b)(3)–1T, removed; 31.3127–1, added; 31.3127–1T, removed; 31.3306(c)(5)–1, amended; 31.3306(c)(5)–1T, removed; 301.7701–2, amended; 301.7701–2T, removed; extending religious and family member FICA and FUTA exceptions to disregarded entities; regulations regarding the indoor tanning services excise tax and disregarded entities (TD 9670) 29, 121

SPECIAL ANNOUNCEMENT

Annual Filing Season Program (RP 42) 29, 193
Procedures to Avoid Backup Withholding (RP 43) 32, 273
INTERNAL REVENUE BULLETIN

The Introduction at the beginning of this issue describes the purpose and content of this publication. The weekly Internal Revenue Bulletins are available at www.irs.gov/irb/.

CUMULATIVE BULLETINS

The contents of the weekly Bulletins were consolidated semiannually into permanent, indexed, Cumulative Bulletins through the 2008–2 edition.

INTERNAL REVENUE BULLETINS ON CD-ROM

Internal Revenue Bulletins are available annually as part of Publication 1796 (Tax Products CD-ROM). The CD-ROM can be purchased from National Technical Information Service (NTIS) on the Internet at www.irs.gov/cdorders (discount for online orders) or by calling 1–877–233–6767. The first release is available in mid-December and the final release is available in late January.

We Welcome Comments About the Internal Revenue Bulletin

If you have comments concerning the format or production of the Internal Revenue Bulletin or suggestions for improving it, we would be pleased to hear from you. You can email us your suggestions or comments through the IRS Internet Home Page (www.irs.gov) or write to the IRS Bulletin Unit, SE:W:CAR:MP:P:SPA, Washington, DC 20224.