

## HIGHLIGHTS OF THIS ISSUE

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

### INCOME TAX

**Rev. Rul. 96-43, page 4.**

**Federal rates; adjusted federal rates; adjusted federal long-term rate; and the long-term exempt rate.** For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for September 1996.

**INTL-4-95, page 8.**

Proposed regulations under sections 861, 865, and 904 of the Code relate to the allocation of loss realized on the disposition of stock.

**Notice 96-43, page 7.**

Guidelines are set forth for determining for August 1996, the weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability for purposes of the full funding limitation of section 412(c)(7) of the Code as amended by the Omnibus Budget Reconciliation Act of 1987 and by the Uruguay Round Agreements Act (GATT).

### TAX CONVENTIONS

**Page 6.**

The bilateral agreements between the United States and Russia, providing for the reciprocal tax exemption of

income from the international operation of ships and/or aircraft, are set forth.

### ADMINISTRATIVE

**Notice 96-44, page 7.**

T.D. 8128, 1987-1 C.B. 325, relating to certain rules for the tax treatment of partnership items, is corrected.

**Announcement 96-81, page 13.**

IA-26-94, 1996-30 I.R.B. 25, relating to the 50-percent exclusion for gain from certain small business stock, is corrected.

**Announcement 96-82, page 14.**

T.D. 8663, 1996-23 I.R.B. 4, concerning the treatment of certain transfers to a controlled corporation, is corrected.

**Announcement 96-83, page 14.**

T.D. 8669, 1996-23 I.R.B. 6, relating to the computation of combined taxable income under the profit split method, is corrected.

**Announcement 96-84, page 14.**

T.D. 8662, 1996-23 I.R.B. 5, relating to the diversification of common trust funds at the time of a combination or division, is corrected.

## Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the

quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency and fairness.

## Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he or she is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

# Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

## **Part I.—1986 Code.**

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

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

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and 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.**

With the exception of the Notice of Proposed Rulemaking and the disbarment and suspension list included in this part, none of these announcements are consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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.

For sale by the Superintendent of Documents U.S. Government Printing Office, Washington, D.C. 20402.

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

## Section 280G.—Golden Parachute Payments

Federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

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

The adjusted federal long-term rate is set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

## Section 412.—Minimum Funding Standards

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

## Section 483.—Interest on Certain Deferred Payments

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, on this page.

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

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

**Federal rates; adjusted federal rates; adjusted federal long-term rate; and the long-term exempt rate.** For purposes of sections 1274, 1288, 382, and other sections of the Code, tables set forth the rates for September 1996.

## Rev. Rul. 96-43

This revenue ruling provides various prescribed rates for federal income tax purposes for September 1996 (the current month.) Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally, Table 5 contains the federal rate for determining the present value of an annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 96-43 TABLE 1

Applicable Federal Rates (AFR) for September 1996

	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	6.02%	5.93%	5.89%	5.86%
110% AFR	6.63%	6.52%	6.47%	6.43%
120% AFR	7.25%	7.12%	7.06%	7.02%
130% AFR	7.86%	7.71%	7.64%	7.59%
<i>Mid-Term</i>				
AFR	6.64%	6.53%	6.48%	6.44%
110% AFR	7.31%	7.18%	7.12%	7.07%
120% AFR	7.99%	7.84%	7.76%	7.71%
130% AFR	8.67%	8.49%	8.40%	8.34%
150% AFR	10.04%	9.80%	9.68%	9.61%
175% AFR	11.76%	11.43%	11.27%	11.17%
<i>Long-Term</i>				
AFR	7.03%	6.91%	6.85%	6.81%
110% AFR	7.74%	7.60%	7.53%	7.48%
120% AFR	8.46%	8.29%	8.21%	8.15%
130% AFR	9.18%	8.98%	8.88%	8.82%

REV. RUL. 96-43 TABLE 2				
Adjusted AFR for September 1996				
	<i>Annual</i>	<i>Period for Compounding</i>		<i>Monthly</i>
		<i>Semiannual</i>	<i>Quarterly</i>	
Short-term adjusted AFR	4.00%	3.96%	3.94%	3.93%
Mid-term adjusted AFR	4.69%	4.64%	4.61%	4.60%
Long-term adjusted AFR	5.63%	5.55%	5.51%	5.49%

REV. RUL. 96-43 TABLE 3	
Rates Under Section 382 for September 1996	
Adjusted federal long-term rate for the current month	5.63%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	5.80%

REV. RUL. 96-43 TABLE 4	
Appropriate Percentages Under Section 42(b)(2) for September 1996	
Appropriate percentage for the 70% present value low-income housing credit	8.61%
Appropriate percentage for the 30% present value low-income housing credit	3.69%

REV. RUL. 96-43 TABLE 5	
Rate Under Section 7520 for September 1996	
Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	8.0%

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, page 4.

**Section 7520.—Valuation Tables**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, page 4.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of September 1996. See Rev. Rul. 96-43, page 4.

## Part II. Treaties and Tax Legislation

### Subpart A.—Tax Conventions

#### RUSSIA

EMBASSY OF  
THE UNITED STATES OF AMERICA  
MOSCOW  
JULY 18, 1994

The Embassy of the United States of America presents its compliments to the Ministry of Foreign Affairs of the Russian Federation. The Government of the United States of America, in accordance with Sections 872(b) and 883(a) of the Internal Revenue Code, agrees to exempt from tax gross income derived from the international operations of ships or aircraft by individual residents of the Russian Federation (other than U.S. citizens) and corporations which are incorporated in the Russian Federation. This exemption is granted on the basis of equivalent exemptions granted by the Russian Federation to individual residents of the United States and to corporations organized in the United States.

In the case of a Russian corporation, the exemptions shall apply only if the corporation meets the ownership or public trading requirements of U.S. law.

Gross income includes all income derived from the international operation of ships or aircraft, including:

- I. Income from the rental on a full (time or voyage) basis of ships or aircraft used in international transport;
- II. Income from the rental on a bareboat basis of ships or aircraft used in international transport if such income is incidental to income from the international operation of ships or aircraft;
- III. Income from the rental of containers and related equipment used in

international transport if such income is incidental to income from the international operation of ships or aircraft;

IV. Gains from the sale or other alienation of ships or aircraft used in international transport by a person primarily engaged in the international operation of ships or aircraft.

When the Government of the Russian Federation agrees to these terms, this will constitute an agreement between the two governments. This agreement shall enter into force on the date of the Government of the Russian Federation's reply note and shall have effect with respect to taxable years beginning on or after January 1, 1991, and terminate from the date of entry into force of the Agreement between the Russian Federation and the United States of America to Avoid Double Taxation and Prevention of Tax Evasion with Respect to Taxes on Income and Capital dated June 17, 1992.

The Embassy of the United States of America avails itself of the opportunity to extend to the Ministry of Foreign Affairs of the Russian Federation renewed assurances of its highest consideration.

RUSSIAN FEDERATION  
MINISTRY OF  
FOREIGN AFFAIRS  
MOSCOW  
JULY 21, 1994

The Ministry of Foreign Affairs of the Russian Federation presents its compliments to the Embassy of the United States of America and has the honor to confirm receipt of the Embassy note no. MFA/112/94 dated July 18, 1994, which reads as follows:

The Russian translation of the above-mentioned note agrees in all substantive

respects with the original English text, with the following exceptions:

*P. 1, para. 1*

English: . . . presents its compliments to the Ministry of Foreign Affairs of the Russian Federation. The Government of the United States of America . . .

Russian: . . . presents its compliments to the Ministry of Foreign Affairs of the Russian Federation *and has the honor to advise that* the Government of the United States of America . . .

*Ibid*

English: the Internal Revenue Code

Russian: the Tax Code

*P. 2, para. IV*

English: . . . by a *person primarily* engaged in the international transport . . .

Russian: . . . by a *juridical* person \_\_\_\_\_ engaged in the international transport . . .

[Translator's note: in the numeration of paragraphs on pp. 1–2, the English text uses Roman numerals, whereas the Russian text employs ordinary numbers]

We have the honor to inform you that the foregoing is acceptable to the Government of the Russian Federation, and it therefore agrees that the U.S. Embassy note and this reply thereto shall constitute an Agreement between the Government of the Russian Federation and the Government of the United States of America, which shall enter into force on the date of this reply.

The Ministry of Foreign Affairs of the Russian Federation avails itself of the opportunity to extend to the Embassy of the United States of America the assurances of its high consideration.

## Part III. Administrative, Procedural, and Miscellaneous

### Weighted Average Interest Rate Update

#### Notice 96-43

Notice 88-73 provides guidelines for determining the weighted average interest rate and the resulting permissible

range of interest rates used to calculate current liability for the purpose of the full funding limitation of § 412(c)(7) of the Internal Revenue Code as amended by the Omnibus Budget Reconciliation Act of 1987 and as further amended by the Uruguay Round Agreements Act,

Pub. L. 103-465 (GATT).

The average yield on the 30-year Treasury Constant Maturities for July 1996 is 7.03 percent.

The following rates were determined for the plan years beginning in the month shown below.

Month	Year	Weighted Average	90% to 108% Permissible Range	90% to 110% Permissible Range
August	1996	6.92	6.22 to 7.47	6.22 to 7.61

#### Drafting Information

The principal author of this notice is Donna Prestia of the Employee Plans Division. For further information regarding this notice, call (202) 622-6076 between 2:30 and 4:00 p.m. Eastern time (not a toll-free number). Ms. Prestia's number is (202) 622-7377 (also not a toll-free number).

#### Miscellaneous Provisions Relating to the Tax Treatment of Partnership Items; Procedure and Administration; OMB Control Numbers; Correction

#### Notice 96-44

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correcting amendment.

SUMMARY: This document contains a correction to temporary regulations (T.D. 8128 [1987-1 C.B. 325]), which were published in the **Federal Register**

on Thursday, March 5, 1987 (52 FR 6779) relating to certain rules for the tax treatment of partnership items.

EFFECTIVE DATE: March 5, 1987.

FOR FURTHER INFORMATION CONTACT: D. Lindsay Russell (202) 622-3050, (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

The temporary regulations that are the subject of this correction is under sections 6221 thru 6233 of the Internal Revenue Code.

##### *Need for Correction*

As published, the temporary regulations (T.D. 8128) contains an error which may prove to be misleading and is in need of clarification.

##### *List of Subjects in 26 CFR Part 301*

Employment taxes, Estate taxes, Ex-

cise taxes, Gift taxes, Income taxes, Penalties, Reporting and recordkeeping requirements.

Accordingly, 26 CFR part 301 is corrected by making the following correcting amendment:

#### PART 301—PROCEDURE AND ADMINISTRATION

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

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

§ 301.6231(a)(7)-1T [Correctly redesignated from § 301.6231(a)(7)-1]

Par. 2. Section 301.6231(a)(7)-1 is redesignated as § 301.6231(a)(7)-1T.

Michael L. Slaughter,  
*Acting Chief, Regulations Unit,*  
*Assistant Chief Counsel (Corporate).*

(Filed by the Office of the Federal Register on July 18, 1996, 8:45 a.m., and published in the issue of the Federal Register for July 19, 1996, 61 F.R. 37683)

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking and Notice of Public Hearing

#### Allocation of Loss on Disposition of Stock

INTL-4-95

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed Income Tax Regulations relating to the allocation of loss realized on the disposition of stock. These regulations will affect United States and foreign shareholders of stock in domestic and foreign corporations. The regulations are necessary to modify existing guidance with respect to stock losses. This document also contains a notice of public hearing on the regulations.

DATES: Written comments must be received by October 7, 1996. Outlines of topics to be discussed at the public hearing scheduled for November 6, 1996, at 10 a.m. must be received by October 16, 1996.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (INTL-4-95), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (INTL-4-95), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW., Washington DC. The public hearing will be held in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Seth B. Goldstein, (202) 622-3850; concerning submissions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Paperwork Reduction Act*

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507).

Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by September 6, 1996.

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

The collection of information under section 865(j)(1) is in § 1.865-2(e)(2)-(ii). The proposed regulations provide that in order for taxpayers to elect retroactive application of the regulations, taxpayers must comply with the reporting requirements contained in § 1.865-2(e)(2)(ii). This information is required by the IRS as a condition for a taxpayer to elect to apply the rules of § 1.865-2 retroactively. This information will be used to determine whether a taxpayer properly applied the regulations. The respondents generally will be U.S. corporations or individuals that sell or otherwise dispose of stock in a foreign corporation of which the seller owns more than 10% of the vote or value.

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

Estimated total annual reporting burden: 4,000 hours. The estimated annual burden per respondent varies from 1 hour to 5 hours, depending on individual circumstances, with an estimated average of 2 hours.

Estimated number of respondents: 2,000.

Estimated annual frequency of responses: Once.

##### *Background*

This document contains proposed regulations amending the Income Tax Regulations (26 CFR Part 1) under sections 861, 865, and 904 of the Internal Revenue Code. These regulations are

also issued under authority contained in section 7805 of the Internal Revenue Code.

##### *Explanation of Provisions*

This notice of proposed rulemaking provides rules under section 865(j) relating to the treatment of losses from the sale or other disposition of stock.

Section 1.865-1 provides that the allocation of loss on the disposition of property not governed by § 1.865-2 continues to be governed by the generally applicable rules of § 1.861-8, except as provided in other administrative pronouncements. For example, Notice 89-58 (1989-1 C.B. 699) remains in effect with respect to losses described in that Notice. The treatment of portfolio stock, which is excluded from § 1.865-2, will be reviewed in the context of a broader project dealing with similar portfolio investments, including debt instruments and derivative financial products. Allocation of loss on the disposition of stock of a regulated investment company and stock of an S corporation also will continue to be governed by §§ 1.861-8(e)(7)(i) and (ii).

Section 1.865-2(a) provides the general rule that stock losses are allocated in the same manner as stock gains (determined without regard to sections 1248 and 865(f)). Thus, stock loss generally is allocated to the residence of the seller. Loss recognized by a United States resident on the disposition of stock attributable to a foreign branch is allocated to foreign source income if a gain would have been taxable by the foreign country and the highest marginal rate of tax imposed in that foreign country is at least 10 percent. Loss recognized by a nonresident alien individual or foreign corporation with respect to stock constituting a United States real property interest reduces United States source income, in accordance with section 897.

Section 1.865-2(b) provides exceptions to the general rule. Section 1.865-2(b)(1) provides a dividend recapture rule that applies to losses realized on a disposition of stock within 24 months following the inclusion of a dividend or similar amount. To the extent of the dividend recapture amount, the loss shall be allocated to the same class of income as the dividend. Under a *de minimis* rule, the recapture rule will not apply if



the sum of all dividend recapture amounts is less than 10 percent of the realized loss.

A dividend recapture amount includes an actual dividend, a subpart F or qualified electing fund inclusion attributable to a dividend received by a controlled foreign corporation in a separate limitation category other than that for passive income, and an inclusion attributable to section 956 or 956A. Dividends from foreign corporations, which often are sheltered from United States tax by foreign tax credits and do not reduce the shareholder's basis in the stock, may reduce the selling price of the stock, thereby creating or increasing a loss on sale. Similarly, the identified subpart F inclusions may increase the shareholder's stock basis without substantially affecting the value of the stock, offering similar opportunities to create a tax mismatch from an economic "wash" by pairing tax-sheltered foreign source inclusions and United States source loss.

Section 1.865-2(b)(2) provides a consistency rule requiring generally that loss recognized on the disposition of an 80%-owned foreign affiliate reduces foreign source passive income if, within the past five years, the seller or any member of its consolidated group recognized gain on the disposition of a foreign affiliate that was sourced under section 865(f). In order to provide relief for taxpayers that could have taken steps to avoid section 865(f) treatment on gain sales occurring prior to the publication of these proposed regulations, the five-year lookback period will be phased in so that losses will be tainted only by reason of gains recognized after September 6, 1996.

Section 1.865-2(b)(3) provides anti-abuse rules designed to prevent taxpayers from changing the allocation of a loss with respect to stock or other property by entering into certain transactions.

Section 1.865-2(c) provides rules of general application. Section 1.865-2(c)(1) provides that a partner's distributive share of loss resulting from a disposition of stock by a partnership is allocated as if the partner disposed of the stock. In an appropriate case the loss may be attributable to a fixed place of business of the partnership rather than to the partner's residence.

Section 1.865-2(c)(2) provides that worthlessness shall be treated as a disposition for purposes of the stock loss allocation rules.

Section 1.865-2(d) provides definitions.

Under § 1.865-2(e), the regulations are proposed to be effective for taxable years beginning after 60 days after the date final regulations are published in the **Federal Register**. However, a taxpayer may elect to apply the regulations retroactively to stock losses in all open post-1986 taxable years. A taxpayer generally may make the election by attaching a statement to an original or amended federal income tax return filed after final regulations are published in the **Federal Register**. However, the election will not be effective unless amended returns are filed within 120 days of the date final regulations are published in the **Federal Register**.

Section 1.904-4(c) is proposed to be amended to provide rules specifically addressing the treatment of loss allocated to the section 904(d) separate category for passive income. The proposed amendments provide that, for purposes of the grouping rules relating to the high-tax kick-out described in section 904(d)(2)(F), a passive loss is initially allocated to a group based on the foreign tax that was, or would have been, imposed on the transaction had the sale resulted in a gain under foreign law. If, after allocation and apportionment of all deductions, net income in a group is less than zero, any taxes imposed with respect to the group are considered related to general limitation income. The net loss is not considered related to general limitation income, but proportionately reduces income in the other passive income groups. The determination of whether income in the positive income groups is high-taxed is made after this allocation of loss groups. Any net loss in the section 904(d) separate category for passive income constitutes a separate limitation loss governed by section 904(f)(5).

#### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It is hereby certified that these regulations do 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 U.S. owners of significant interests in foreign corporations, which owners generally are large multinational

corporations. This certification is also based upon the fact that, even in cases in which the regulation applies to small entities, the burden imposed by the collection of information in the regulation, which is merely an election to apply the regulation to prior taxable years, is not substantial and, therefore, the collection of information will not impose a significant economic impact on such entities. Therefore, 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 Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### *Comments and Public Hearing*

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (signed original and eight (8) copies) that are timely submitted to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for November 6, 1996, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue NW., Washington DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons that wish to present oral comments at the hearing must submit written comments by October 7, 1996 and submit an outline of topics to be discussed and time to be devoted to each topic (signed original and eight (8) copies) by October 16, 1996.

A period of 10 minutes will be allotted to each person for making comments.

An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

#### *Drafting Information*

The principal author of these regulations is Seth B. Goldstein, of the Office of the Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

*Adoption of Amendments to the Regulations*

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

**PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by adding entries in numerical order to read as follows:

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

Section 1.865-1 is also issued under 26 U.S.C. 865(j)(1).

Section 1.865-2 is also issued under 26 U.S.C. 865(j)(1).

Par. 2. Section 1.861-8 is amended by adding paragraph (e)(7)(iii) to read as follows: § 1.861-8 Computation of taxable income from sources within the United States and from other sources and activities.

\* \* \* \* \*

(e) \* \* \*

(7) \* \* \*

(iii) *Special rules for allocation of loss from disposition of stock.* See § 1.865-2 for special rules regarding the allocation of loss recognized on certain dispositions of stock in taxable years beginning after December 31, 1986.

Par. 3. Sections 1.865-1 and 1.865-2 are added under the undesignated center heading, DETERMINATION OF SOURCES OF INCOME, to read as follows:

*§ 1.865-1 Loss from the disposition of personal property.*

Allocation of loss on the sale or other disposition of portfolio stock, stock of a regulated investment company (as defined in section 851), stock of an S corporation (as defined in section 1361), and other personal property not governed by § 1.865-2 is governed by § 1.861-8 or other administrative pronouncements. Portfolio stock is, with respect to a taxpayer, stock in a corporation in which the taxpayer owns, or is considered to own under the rules of section 267(c), less than 10 percent of the total combined voting power of all classes of stock entitled to vote of such corporation and less than 10 percent of the total value of the stock of such corporation.

*§ 1.865-2 Loss from the disposition of certain stock.*

(a) *General rules for allocation of loss on disposition of stock—(1) Allocation against gain.* Except as otherwise

provided in § 1.865-1 and paragraph (b) of this section, loss recognized on the sale or other disposition of stock shall be allocated to the class of gross income and, if necessary, apportioned between the statutory grouping of gross income (or among the statutory groupings) and the residual grouping of gross income, with respect to which gain (other than gain treated as a dividend under section 1248) from the sale of such stock would give rise in the hands of the seller (without regard to section 865(f)). For purposes of section 904, any such loss shall be allocated to the separate category to which such gain would have been assigned (without regard to section 904(d)(2)(A)(iii)(III)). For purposes of § 1.904-4(c)(2)(ii)(A), any loss allocated to passive income shall be allocated (prior to the application of § 1.904-4(c)(2)(ii)(B)) to the group of passive income to which gain on the sale would have been assigned if the sale of the stock had resulted in the recognition of a gain under the law of the relevant foreign jurisdiction or jurisdictions. See section 904(f)(5) and the regulations under that section for rules regarding the treatment of separate limitation losses.

(2) *Stock attributable to foreign office.* Except as otherwise provided in § 1.865-1 and paragraph (b) of this section, in the case of loss on the sale or other disposition of stock (other than stock constituting inventory) by a United States resident that is attributable to an office or other fixed place of business in a foreign country within the meaning of section 865(e)(3), the loss shall be allocated to reduce foreign source income if a gain would have been taxable by the foreign country and the highest marginal rate of tax imposed in the foreign country is at least 10 percent.

(3) *Stock constituting a United States real property interest.* Loss recognized by a nonresident alien individual or a foreign corporation on the sale or other disposition of stock that constitutes a United States real property interest shall be allocated to reduce United States source income. For additional rules governing the treatment of such loss, see section 897 and the regulations thereunder.

(b) *Exceptions—(1) Dividend recapture exception—(i) In general.* Except as otherwise provided in § 1.865-1, if a taxpayer realizes a loss on a disposition of stock, and the taxpayer included in income a dividend recapture amount (or

amounts) with respect to such stock at any time during the recapture period, then, to the extent of the dividend recapture amount (or amounts), the loss shall be allocated and apportioned on a proportionate basis to the class or classes of gross income or the statutory or residual grouping or groupings of gross income to which the dividend recapture amount was assigned.

(ii) *Exception for de minimis amounts.* Paragraph (b)(1)(i) of this section shall not apply to a loss realized by a taxpayer on the disposition of stock if the sum of all dividend recapture amounts included in income by the taxpayer with respect to such stock during the recapture period is less than 10 percent of the realized loss.

(2) *Consistency exception—(i) In general.* Except to the extent provided in paragraph (b)(1) of this section, loss recognized by a taxpayer with respect to the sale or other disposition of stock of a foreign affiliate (or of a corporation that was a foreign affiliate within the five-year period preceding the date of the sale) or a foreign affiliate holding company shall be allocated to reduce foreign source income if the taxpayer (or, in the case of a taxpayer that is a member of a consolidated group (within the meaning of § 1.1502-1(h)) at the time the loss is recognized, the consolidated group) recognized gain on the disposition of any stock that was sourced under section 865(f) within the five-year period ending on the last day of the taxable year in which the loss was recognized. See paragraph (a)(1) of this section for rules relating to the allocation of the loss to separate categories described in section 904(d).

(ii) *Phased-in lookback period.* The rule of paragraph (b)(2)(i) of this section shall apply only if gain sourced under section 865(f) was recognized after September 6, 1996.

(3) *Anti-abuse rules.* If one of the principal purposes of a reorganization within the meaning of section 368(a), liquidation under section 332, transfer to a corporation under section 351, transfer to a partnership under section 721, transfer to a trust, distribution by a partnership, distribution by a trust, or transfer to or from a qualified business unit (within the meaning of section 989(a)) is to change the allocation of a built-in loss on the disposition of stock (or other personal property), the loss shall be allocated as if it were recognized on the disposition of the stock (or other personal property) immediately

prior to the reorganization, liquidation, transfer, or distribution. In addition, if a loss recognized by a taxpayer with respect to the sale or other disposition of stock in a corporation is primarily attributable to loss with respect to one or more financial instruments held by the corporation, and one of the taxpayer's principal purposes for holding the financial instrument or instruments through the corporation is to allocate loss under § 1.865-2, the stock loss shall be allocated under § 1.865-1 as if it were recognized on the disposition of such financial instrument or instruments. Whether a taxpayer has a principal purpose to allocate loss under § 1.865-2 shall be determined by taking into account all the facts and circumstances, including whether the corporation engages in business activities (other than trading financial instruments) and whether the taxpayer or any related person or persons (within the meaning of section 267(b) or 954(d)(3)) hold positions that offset loss positions held by the corporation. For purposes of this paragraph (b)(3), positions are offsetting if the risk of loss of holding one or more positions is substantially diminished by holding one or more other positions. A person may have a principal purpose of affecting loss allocation even though this purpose is outweighed by other purposes (taken together or separately).

(4) *Example.* The application of this paragraph (b) may be illustrated by the following example:

*Example.* (i) *P*, a domestic corporation, is a United States shareholder of *N*, a controlled foreign corporation. *N* has never had any subpart F income and all of its earnings and profits are described in section 959(c)(3). On August 5, 1997, *N* distributes a dividend to *P* in the amount of \$100. The dividend gives rise to a \$5 foreign withholding tax, and *P* is deemed to have paid an additional \$45 of foreign income tax with respect to the dividend under section 902. Under section 904(d)(3) the dividend is general limitation income described in section 904(d)(1)(I).

(ii) On February 6, 1998, *P* sells its shares of *N* and recognizes a \$110 loss. In 1998, *P* has the following taxable income, excluding the loss on the sale of *N*:

(A) \$1,000 of foreign source income that is general limitation income described in section 904(d)(1)(I), which is subject to foreign taxes of \$400;

(B) \$1,000 of foreign source capital gain that is passive income described in section 904(d)(1)(A) attributable to gain on the sale of stock in a foreign affiliate that is sourced under section 865(f), which is subject to foreign taxes of \$30.

(iii) The \$100 dividend paid in 1997 is a dividend recapture amount that was included in *P*'s income within the recapture period preceding the disposition of the *N* stock. The de minimis exception of paragraph (b)(1)(ii) of this section

does not apply because the \$100 dividend recapture amount exceeds 10 percent of the \$110 loss. Therefore, to the extent of the \$100 dividend recapture amount, the loss must be allocated under paragraph (b)(1)(i) of this section to the separate limitation category to which the dividend was assigned (general limitation income).

(iv) Because *P* recognized gain on the sale of stock in a foreign affiliate that was sourced under section 865(f) within the period described in paragraph (b)(2)(i) of this section, *P*'s remaining \$10 loss on the disposition of the *N* stock is allocated to foreign source passive income under paragraph (b)(2)(i) of this section.

(v) After allocation of the stock loss, *P*'s taxable income in 1998 consists of \$900 of foreign source general limitation income and \$990 of foreign source passive income.

(c) *Rules of application*—(1) *Loss recognized by partnership.* A partner's distributive share of loss resulting from the sale or other disposition of stock by a partnership shall be allocated and apportioned in accordance with this section as if the partner had disposed of the stock. If a sale of stock is attributable to an office or other fixed place of business of the partnership within the meaning of section 865(e)(3), such office or fixed place of business shall be considered to be an office of the partner for purposes of this section.

(2) *Worthless stock.* For purposes of this section, worthlessness giving rise to a deduction under section 165(g) (including section 165(g)(3)) with respect to stock shall be treated as a disposition.

(d) *Definitions*—(1) *Terms defined in § 1.861-8.* See § 1.861-8 for the meaning of *class of gross income*, *statutory grouping of gross income*, and *residual grouping of gross income*.

(2) *Dividend recapture amount.* A dividend recapture amount is a dividend (except for an amount treated as a dividend under section 78), an inclusion described in section 951(a)(1)(A)(i) (but only to the extent attributable to a dividend included in the earnings of a controlled foreign corporation that is included in foreign personal holding company income under section 954(c)-(1)(A) and that, pursuant to section 904(d)(3)(B), is treated as income in a separate category other than the separate category for passive income described in section 904(d)(2)(A)), an inclusion described in section 951(a)(1)(B) or (C), and an inclusion described in section 1293(a)(1) (but only to the extent attributable to a dividend that is included in the earnings of a qualified electing fund and that, pursuant to section 904(d)(3)-(I), is treated as income in a separate category other than the separate cat-

egory for passive income described in section 904(d)(2)(A)).

(3) *Foreign affiliate.* A foreign affiliate is a foreign corporation that is a member of the affiliated group (within the meaning of section 1504(a) without regard to section 1504(b)) that includes the taxpayer.

(4) *Foreign affiliate holding company.* A foreign affiliate holding company is any corporation, substantially all the assets of which consist of stock of one or more foreign affiliates, held directly or indirectly. For purposes of this paragraph, any assets acquired or held by a corporation with a principal purpose of avoiding foreign affiliate holding company status shall be disregarded.

(5) *Recapture period.* A recapture period is the 24-month period preceding the date on which a taxpayer realizes a loss on a disposition of stock, increased by any period of time in which the taxpayer has diminished its risk of loss in a manner described in section 246(c)(4) and the regulations thereunder.

(6) *Taxpayer.* A taxpayer shall include all predecessors or successors of the taxpayer.

(7) *United States resident.* See section 865(g) and the regulations thereunder for the definition of United States resident.

(e) *Effective date*—(1) *In general.* This section is effective for taxable years beginning after the date that is 60 days after the date these regulations are published as final regulations in the **Federal Register**.

(2) *Prior year election*—(i) *In general.* A taxpayer may elect to apply the rules of this section to all (but not less than all) of its taxable years that begin after December 31, 1986, and on or before the date that is 60 days after the date these regulations are published as final regulations in the **Federal Register**, and with respect to which the statute of limitations expires after the date that is 120 days after the date these regulations are published as final regulations in the **Federal Register**. The election shall be effective only if the taxpayer satisfies all the applicable requirements specified in paragraph (e)(2)(ii) of this section.

(ii) *Requirements for election*—(A) *Statement filed with original or amended return.* For each taxable year subject to the election, a taxpayer shall file an original or amended federal income tax return that reflects the rules of this section and includes the statement

described in paragraph (e)(2)(ii)(C) of this section. Amended returns filed pursuant to this section must be filed on or before the date that is 120 days after the date these regulations are published as final regulations in the **Federal Register**.

(B) *Presentation of statement upon audit.* A taxpayer that is under examination with respect to any taxable year subject to the election on the date that is 120 days after the date these regulations are published as final regulations in the **Federal Register** must furnish a copy of the statement described in paragraph (e)(2)(ii)(C) of this section for all years subject to the election to the revenue agent responsible for examining its federal income tax returns on or before the date that is 140 days after the date these regulations are published as final regulations in the **Federal Register**. For purposes of this paragraph (e)(2)(ii)(B), a taxpayer is under examination beginning on the date the taxpayer (or any member of the consolidated group of which the taxpayer is a member) has been contacted in any manner by a representative of the Internal Revenue Service for the purpose of scheduling any type of examination of any of its federal income tax returns and ending on the earliest of the date: the taxpayer (or consolidated group of which the taxpayer is a member) receives a "no change" letter; the taxpayer (or consolidated group of which the taxpayer is a member) pays the deficiency (or proposed deficiency); or on which a deficiency, jeopardy, termination, bankruptcy, or receivership assessment is made. An electing taxpayer that is not under examination with respect to any taxable year subject to the election on the date that is 120 days after the date these regulations are published as final regulations in the **Federal Register** and is contacted thereafter by a representative of the Internal Revenue Service for the purpose of scheduling any type of examination of any of its federal income tax returns for a year subject to the election must furnish a copy of the statement described in paragraph (e)(2)(ii)(C) of this section for all years subject to the election to the revenue agent responsible for examining its federal income tax returns within 20 days of being contacted.

(C) *Contents of statement.* The statement shall be entitled "ELECTION UNDER § 1.865-2(e)(2) TO APPLY RETROACTIVELY § 1.865-2 STOCK LOSS ALLOCATION RULES." The statement shall identify, for the taxable

year subject to the election, each loss from the disposition of stock that is subject to this section and that was incurred by the taxpayer or by any controlled foreign corporation (within the meaning of section 953(c)(1)(B) or 957) with respect to which the taxpayer is a United States shareholder (within the meaning of section 951(b) or 953(c)(1)(A)). For each such loss, the statement shall provide the name and identifying number of the entity that incurred the loss, the amount of the loss, and the paragraph of this section under which the loss is allocated. Each loss subject to paragraph (b)(1) of this section shall be separately identified with a notation stating "Subject to dividend recapture under § 1.865-2(b)(1)." The statement shall also include the following declaration: "No losses, other than those so identified herein, are subject to § 1.865-2(b)(1)." The statement shall indicate whether the taxpayer or any controlled foreign corporation (within the meaning of section 953(c)(1)(B) or 957) with respect to which the taxpayer is a United States shareholder (within the meaning of section 951(b) or 953(c)(1)(A)) acquired the stock after July 8, 1996, as a result of a transaction described in paragraph (b)(3) of this section (regardless of the purpose or purposes of the transaction). An election shall not be effective unless each statement required by this paragraph (e)(2)(ii) contains all the information specified herein.

Par. 4. Section 1.904-0 is amended by revising the entry for § 1.904-4(c)(2)(ii) and adding entries for paragraphs (c)(2)(ii)(A) and (B) of that section to read as follows:

§ 1.904-0 *Outline of regulation provisions for section 904.*

\* \* \* \* \*

§ 1.904-4 *Separate application of section 904 with respect to certain categories of income.*

\* \* \* \* \*

(c) \* \* \*

(2) \* \* \*

(ii) Grouping rules.

(A) Initial allocation and apportionment of deductions.

(B) Reallocation of loss groups.

Par. 5. Section 1.904-4 is amended by revising paragraphs (c)(1) and (c)(2) and adding paragraph (c)(8) *Example 11* and *Example 12* to read as follows:

(c) *High-taxed income*—(1) *In general.* Income received or accrued by a

United States person that would otherwise be passive income shall not be treated as passive income if the income is determined to be high-taxed income. Income shall be considered to be high-taxed income if, after allocating expenses, losses and other deductions of the United States person to that income under paragraph (c)(2)(ii) of this section, the sum of the foreign income taxes paid or accrued by the United States person with respect to such income and the foreign taxes deemed paid or accrued by the United States person with respect to such income under section 902 or section 960 exceeds the highest rate of tax specified in section 1 or section 11, whichever applies (and with reference to section 15 if applicable), multiplied by the amount of such income (including the amount treated as a dividend under section 78). If, after application of this paragraph (c), income that would otherwise be passive income is determined to be high-taxed income, such income shall be treated as general limitation income, and any taxes imposed on that income shall be considered related to general limitation income under § 1.904-6. If, after application of this paragraph (c), passive income is less than zero, the loss shall constitute a passive separate limitation loss (subject to the rules of section 904(f)(5) and the regulations under that section), but any taxes imposed on passive income shall be considered related to general limitation income under § 1.904-6. For additional rules regarding losses related to passive income, see paragraph (c)(2) of this section. Income and taxes shall be translated at the appropriate rates, as determined under sections 986, 987 and 989 and the regulations under those sections, before application of this paragraph (c). For purposes of allocating taxes to groups of income, United States source passive income is treated as any other passive income. In making the determination whether income is high-taxed, however, only foreign source income, as determined under United States tax principles, is relevant. See paragraph (c)(8) *Examples* (10), (11) and (12) of this section for examples illustrating the application of this paragraph (c)(1) and paragraph (c)(2) of this section.

(2) *Grouping of items of income in order to determine whether passive income is high-taxed income*—(i) *Effective date.* For purposes of determining whether passive income is high-taxed income, the grouping rules of paragraphs (c)(3), (c)(4), and (c)(5) of this

section apply to taxable years beginning after December 31, 1987. See notice 87-6 for the grouping rules applicable to taxable years beginning after December 31, 1986 and before January 1, 1988. Paragraph (2)(ii)(B) of this section is effective for taxable years beginning after the date that is 60 days after the date these regulations are published as final regulations in the **Federal Register**.

(ii) *Grouping rules(A) Initial allocation and apportionment of deductions.* For purposes of determining whether passive income is high-taxed, expenses, losses and other deductions shall be allocated and apportioned initially to each of the groups of passive income (described in paragraphs (c)(3), (4), and (5) of this section) under the rules of §§ 1.861-8 through 1.861-14T, 1.865-1, and 1.865-2. Taxpayers that allocate and apportion interest expense on an asset basis may nevertheless apportion passive interest expense among the groups of passive income on a gross income basis. If loss from the disposition of property gives rise to foreign tax (e.g., the transaction giving rise to the loss is treated under foreign law as having given rise to a gain), the foreign tax shall be allocated to the group of passive income to which the loss is allocated under this paragraph (c)(2)(ii)-(A), without regard to paragraph (c)(2)(ii)(B) of this section. A determination of whether passive income is high-taxed shall be made only after application of paragraph (c)(2)(ii)(B) of this section (if applicable).

(B) *Reallocation of loss groups.* If, after allocation and apportionment of expenses, losses and other deductions under paragraph (c)(2)(ii)(A) of this section, the sum of the allocable deductions exceeds the gross income in one or more groups, the excess deductions shall proportionately reduce income in the other groups (but not below zero), and any taxes imposed with respect to such loss group or groups shall be considered related to general limitation income.

\* \* \* \* \*

(8) \* \* \*

*Example 11.* P, a domestic corporation, earns the following items of gross income: \$100 of foreign source, passive limitation interest income not subject to any foreign tax, \$200 of foreign source, passive limitation royalty income subject to a 5 percent foreign withholding tax (foreign tax paid is \$10), \$1300 of foreign source, passive limitation rental income subject to a 25 percent foreign withholding tax (foreign tax paid is \$325), \$500 of foreign source, general limitation income that gives rise to a \$250 foreign tax, and \$2000 of

U.S. source capital gain that is not subject to any foreign tax. P has a \$700 deduction allocable to its passive rental income. P's only other deduction is a \$500 capital loss on a sale of stock that is allocated to foreign source passive limitation income under § 1.865-2(b)(2). If P had recognized a gain on the stock sale under foreign law, the gain would not have been subject to foreign tax. The \$500 capital loss is initially allocated to the group of passive income not subject to any foreign tax, and the \$400 amount by which the capital loss exceeds the income in the group must be reapportioned to the other groups under paragraph (c)(2)(ii)(B) of this section. The net royalty income is thus reduced by \$100 to \$100 (\$200 - (\$400 x (200/800))) and the net rental income is reduced by \$300 to \$300 (\$1300 - \$700 - (\$400 x (600/800))). The \$100 net royalty income is not high-taxed and remains passive income. The \$300 net rental income is high-taxed because the foreign taxes exceed the highest United States rate of tax on that income. Under the high-tax kick-out, the \$300 of net rental income (the gross rental income and expenses allocated and apportioned thereto) and the \$325 of associated foreign tax are assigned to the general limitation category.

*Example 12.* The facts are the same as in *Example 11* except the amount of the capital loss that is allocated under § 1.865-2(b)(2) and paragraph (c)(2) of this section to the group of foreign source passive income subject to no foreign tax is \$1100. Under paragraph (c)(2)(ii)(B) of this section, the excess deductions of \$1000 must be reapportioned to the \$200 of net royalty income subject to a 5% withholding tax and the \$600 of net rental income subject to a 25% withholding tax. The income in each of these groups is reduced to zero, and the foreign taxes imposed on the rental and royalty income are considered related to general limitation income. The remaining loss of (\$200) constitutes a separate limitation loss with respect to passive income.

\* \* \* \* \*

Margaret Milner Richardson,  
*Commissioner of Internal Revenue.*

(Filed by the Office of the Federal Register on July 5, 1996, 8:45 a.m., and published in the issue of the Federal Register for July 8, 1996, 61 F.R. 35696)

**Qualified Small Business Stock; Correction**

**Announcement 96-81**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains corrections to notice of proposed rulemaking and notice of public hearing (IA-26-94 [1996-30 I.R.B. 24]) which was published in the **Federal Register** on Thursday, June 6, 1996 (61 FR 28821). The notice of proposed rulemaking and notice of public hearing relates to the 50-percent exclusion for gain from certain small business stock.

FOR FURTHER INFORMATION CONTACT: Catherine A. Prohofsky (202) 622-4930 (not a toll-free number).

**SUPPLEMENTARY INFORMATION:**

*Background*

The notice of proposed rulemaking that is subject to these corrections are under section 1202 of the Internal Revenue Code.

*Need for Correction*

As published, the notice of proposed rulemaking and notice of public hearing (IA-26-94) contain errors which may prove to be misleading and are in need of clarification.

*Correction of Publication*

Accordingly, the publication of proposed rulemaking (IA-26-94) which is the subject of FR Doc. 96-14231 is corrected as follows:

1. On page 28821, column 3, in the preamble, under the caption "DATES:", lines 3 and 4, the language "public hearing scheduled for October 3, 1996 must be" is corrected to read "public hearing scheduled for October 3, 1996, must be".

**§ 1.1202-0 [Corrected]**

2. On page 28822, column 3, § 1.1202-0, table of contents, the entries for paragraphs (b)(1) and (2) under § 1.1202-2, are corrected to read as follows:

*§ 1.1202-0 Table of contents.*

\* \* \* \* \*

*§ 1.1202-2 Qualified Small Business Stock; Effect of Redemptions.*

\* \* \* \* \*

- (b) \* \* \*
- (1) In general.
- (2) De minimis amount.

\* \* \* \* \*

Cynthia E. Grigsby,  
*Chief, Regulations Unit,*  
*Assistant Chief Counsel (Corporate).*

(Filed by the Office of the Federal Register on July 25, 1996, 8:45 a.m., and published in the issue of the Federal Register for July 26, 1996, 61 F.R. 39104)

## Transfers to Investment Companies; Correction

### Announcement 96-82

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to final regulations (T.D. 8663 [1996-23 I.R.B. 4]) which were published in the **Federal Register** on Thursday, May 2, 1996 (61 FR 19544). The final regulations concern the treatment of certain transfers to a controlled corporation.

EFFECTIVE DATE: May 2, 1996

FOR FURTHER INFORMATION CONTACT: Andrew M. Eisenberg, (202) 622-7790 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

The final regulations that are the subject of this correction are under section 351 of the Internal Revenue Code.

##### *Need for Correction*

As published, T.D. 8663 contains an error that is in need of correction.

##### *Correction of Publication*

Accordingly, the publication of the final regulations which are the subject of FR Doc. 96-10394 is corrected as follows:

#### Part 1 [Corrected]

On page 19545, column 3, in amendatory instruction "Paragraph 1.", lines 1 and 2, the language "Paragraph 1. The authority citation for part 1 continues to read as follows:" is corrected to read "Paragraph 1. The authority citation for part 1 is amended by adding an entry in numerical order to read as follows:".

Cynthia E. Grigsby,  
Chief, Regulations Unit,  
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on June 25, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 26, 1996, 61 F.R. 39072)

## Computation of Combined Taxable Income Under the Profit Split Method When the Possession Product Is a Component Product or an End-Product Form for Purposes of the Possessions Credit Under Section 936; Correction

### Announcement 96-83

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains corrections to final regulations (T.D. 8669 [1996-23 I.R.B. 6]) which were published in the Federal Register on Friday, May 10, 1996 (61 FR 21366). The final regulations relate to the computation of combined taxable income under the profit split method.

EFFECTIVE DATE: May 10, 1996

FOR FURTHER INFORMATION CONTACT: Jacob Feldman (202) 622-3870 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

The final regulations that are subject to these corrections are under section 936 of the Internal Revenue Code.

##### *Need for Correction*

As published, the final regulations [T.D. 8669] contain errors which may prove to be misleading and are in need of clarification.

##### *Correction of Publication*

Accordingly, the publication of the final regulations (TD 8669) which is the subject of FR Doc. 96-11639, is corrected as follows:

1. On page 21366, column 3, in the preamble, following the paragraph heading "**Discussion**", the first full paragraph in the column, line 4, the language "forms under the profit-split method" is corrected to read "forms under the profit split method".

2. On page 21367, column 1, in the preamble, following the paragraph heading "**Discussion**", the second full paragraph in the column, lines 12 and 13, the language "regulation is effective for taxable years ending 30 days after May

10, 1996. If" is corrected to read "regulations apply to taxable years ending after June 9, 1996. If".

#### § 1.936-6 [Corrected]

3. On page 21368, § 1.936-6, in paragraph (b)(1), in A. 12 (iv) in the table, under the heading "Production costs (excluding costs of materials):", item 3, the language "3. P's costs for the CPU's (the possession product)" is corrected to read "3. P's costs for the CPUs (the possession product)".

4. On page 21369, column 3, § 1.936-6, paragraph (b)(1), under A. 12 (vii), line 3, the language "ending 30 days after May 10, 1996. If" is corrected to read "ending after June 9, 1996. If".

Cynthia E. Grigsby,  
Chief, Regulations Unit,  
Assistant Chief Counsel (Corporate).

(Filed by the Office of the Federal Register on July 25, 1996, 8:45 a.m., and published in the issue of the Federal Register for July 26, 1996, 61 F.R. 39071)

## Diversification of Common Trust Funds; Correction

### Announcement 96-84

AGENCY: Internal Revenue Service, Treasury.

ACTION: Correction to final regulations.

SUMMARY: This document contains a correction to final regulations (T.D. 8662 [1996-23 I.R.B. 5]) which were published in the **Federal Register** on Thursday, May 2, 1996 (61 FR 19546). The final regulations relate to the diversification of common trust funds at the time of a combination or division.

EFFECTIVE DATE: May 2, 1996.

FOR FURTHER INFORMATION CONTACT: Steven Schneider, (202) 622-3060 (not a toll-free number).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

The final regulations that are the subject of this correction are under section 584 of the Internal Revenue Code.

*Need for Correction*

As published, T.D. 8662 contains an error that is in need of correction.

*Correction of Publication*

Accordingly, the publication of final regulations which are the subject of FR Doc 96-10393 is corrected as follows.

**§ 1.584-4 [Corrected]**

On page 19547, column 1, § 1.584-4(a), the fifteenth line from the bottom of the paragraph, the language “participant in substantially the same as” is corrected to read “participant is substantially the same as”.

Cynthia E. Grigsby,  
*Chief, Regulations Unit,*  
*Assistant Chief Counsel (Corporate).*

(Filed by the Office of the Federal Register on June 25, 1996, 8:45 a.m., and published in the issue of the Federal Register for June 26, 1996, 61 F.R. 39072)

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## 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 law 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 the new ruling.

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

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

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

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

## Abbreviations

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

A—Individual.

Acq.—Acquiescence.

B—Individual.

BE—Beneficiary.

BK—Bank.

B.T.A.—Board of Tax Appeals.

C.—Individual.

C.B.—Cumulative Bulletin.

CFR—Code of Federal Regulations.

CI—City.

COOP—Cooperative.

Ct.D.—Court Decision.

CY—County.

D—Decedent.

DC—Dummy Corporation.

DE—Donee.

Del. Order—Delegation Order.

DISC—Domestic International Sales Corporation.

DR—Donor.

E—Estate.

EE—Employee.

E.O.—Executive Order.

ER—Employer.

ERISA—Employee Retirement Income Security Act.

EX—Executor.

F—Fiduciary.

FC—Foreign Country.

FICA—Federal Insurance Contribution Act.

FISC—Foreign International Sales Company.

FPH—Foreign Personal Holding Company.

F.R.—Federal Register.

FUTA—Federal Unemployment Tax Act.

FX—Foreign Corporation.

G.C.M.—Chief Counsel's Memorandum.

GE—Grantee.

GP—General Partner.

GR—Grantor.

IC—Insurance Company.

I.R.B.—Internal Revenue Bulletin.

LE—Lessee.

LP—Limited Partner.

LR—Lessor.

M—Minor.

Nonacq.—Nonacquiescence.

O—Organization.

P—Parent Corporation.

PHC—Personal Holding Company.

PO—Possession of the U.S.

PR—Partner.

PRS—Partnership.

PTE—Prohibited Transaction Exemption.

Pub. L.—Public Law.

REIT—Real Estate Investment Trust.

Rev. Proc.—Revenue Procedure.

Rev. Rul.—Revenue Ruling.

S—Subsidiary.

S.P.R.—Statements of Procedural Rules.

Stat.—Statutes at Large.

T—Target Corporation.

T.C.—Tax Court.

T.D.—Treasury Decision.

TFE—Transferee.

TFR—Transferor.

T.I.R.—Technical Information Release.

TP—Taxpayer.

TR—Trust.

TT—Trustee.

U.S.C.—United States Code.

X—Corporation.

Y—Corporation.

Z—Corporation.



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<sup>1</sup>A cumulative list of all Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in Internal Revenue Bulletins 1996–1 through 1996–26 will be found in Internal Revenue Bulletin 1996–27, dated July 1, 1996.

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<sup>1</sup>A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1996–1 through 1996–26 will be found in Internal Revenue Bulletin 1996–27, dated July 1, 1996.