

Internal Revenue bulletin

Bulletin No. 1997-37
September 15, 1997

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. 97-37, page 15.

LIFO; price indexes; department stores. The July 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 1997.

T.D. 8725, page 16.

This final regulation contains miscellaneous sections of the Code affected by the Taxpayer Bill of Rights 2 and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996.

T.D. 8728, page 4.

Final and temporary regulations relate to the requirements for changing a method of accounting for costs subject to section 263A of the Code.

REG-105160-97, page 22.

The proposed regulations relate to qualified nonrecourse financing under section 465 of the Code. A public hearing will be held on December 10, 1997.

EMPLOYEE PLANS

REG-106043-97, page 24.

Proposed regulations under section 401 of the Code relate to the remedial amendment period during which a sponsor of a qualified retirement plan or an employer maintaining a

qualified retirement plan can make retroactive amendments to the plan to eliminate certain qualification defects for the entire period.

EXEMPT ORGANIZATIONS

Announcement 97-92, page 26.

A list is given of organizations now classified as private foundations.

EXCISE TAX

Announcement 97-91, page 25.

This announcement provides additional excise tax changes made by the Taxpayer Relief Act of 1997. These changes affect taxes on fuels, communications, air transportation, heavy highway vehicles, luxury automobiles, and arrow components.

ADMINISTRATIVE

Notice 97-50, page 21.

Timely filing or payment; private delivery services. Taxpayers are informed that the list of private delivery services designed under section 7502 of the Code in Notice 97-26, 1997-17 I.R.B. 6, will remain in effect until further notice. The rules for application periods and issuance of new designation lists by the Service are modified.

Finding Lists begin on page 29.



Department of the Treasury
Internal Revenue Service

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 prod-

ucts 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 semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

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

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

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

dures 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 a cumulative index for the matters published during the preceding months. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semiannual period, respectively.

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

Section 263A.—Capitalization and Inclusion in Inventory Costs of Certain Expenses

26 CFR 1.263A-7: Changing a method of accounting under section 263A.

T.D. 8728

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Procedure for Changing a Method of Accounting under Section 263A

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains final regulations relating to the requirements for changing a method of accounting for costs subject to section 263A. The regulations provide guidance regarding changes in method of accounting for costs incurred in producing property and acquiring property for resale. The regulations affect taxpayers changing their method of accounting for costs subject to section 263A.

DATES: These regulations are effective August 5, 1997.

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

SUPPLEMENTARY INFORMATION:

Background

On March 30, 1987 and August 7, 1987, temporary regulations under section 263A were published in the **Federal Register** (T.D. 8131, 52 F.R. 10052 [1987-1 C.B. 98] and T.D. 8148, 52 F.R. 29375 [1987-2 C.B. 70]), and cross-referenced to notices of proposed rulemaking published in the **Federal Register** on the same date (52 F.R. 10118 [LR-168-86, 1987-1 C.B. 808] and 52 F.R. 29391 [LR-37-87, 1987-2 C.B. 1054]). The temporary regulations contain rules for

taxpayers changing their method of accounting to comply with the capitalization rules of section 263A. A public hearing on these temporary and proposed regulations was held on December 7, 1987.

On August 9, 1993, final regulations under section 263A were published in the **Federal Register** (T.D. 8482, 58 F.R. 42198 [1993 C.B. 77]). These final regulations did not address the accounting method provisions in the 1987 temporary regulations, which continued in effect. On August 5, 1994, final and temporary regulations were published in the **Federal Register** (T.D. 8559, 59 F.R. 39958 [1994-2 C.B. 32]). These final regulations address “pick and pack costs” and other expenses. The August 5, 1994 temporary regulations renumbered the accounting method provisions in the 1987 temporary regulations from §1.263A-1T(e) to §1.263A-7T.

This document adopts, with modifications, §1.263A-7T as final regulations.

Explanation of Provisions

In 1987, the IRS and the Treasury Department issued temporary regulations that provide guidance to taxpayers changing their method of accounting to comply with the capitalization rules of section 263A. The regulations provide automatic consent for taxpayers required to change their method of accounting for the first taxable year section 263A was effective.

Subsequent to promulgation of the 1987 temporary regulations, the IRS and the Treasury Department issued various revenue procedures that set forth rules and procedures applicable to certain changes in method of accounting for costs subject to section 263A for which taxpayers can obtain automatic consent. These revenue procedures provide automatic consent to change the method of accounting in years other than the first taxable year section 263A was effective. Where automatic consent is not available by revenue procedure, taxpayers can obtain the Commissioner’s consent to change a method of accounting for costs subject to section 263A under Rev. Proc. 97-27 (1997-21 I.R.B. 10).

Rev. Proc. 97-27 and the automatic change revenue procedures describe how a change in method of accounting may be

effected, but they do not describe how inventory and other property on hand at the beginning of the year of change should be revalued. These final regulations provide guidance regarding how taxpayers must revalue property in connection with a change in method of accounting for costs subject to section 263A. The revaluation rules for inventory are substantially similar to the revaluation rules contained in the 1987 temporary regulations. Section 1.263A-7(c) provides guidance regarding how items or costs included in beginning inventory in the year of change must be revalued. Section 1.263A-7(d) provides guidance regarding how non-inventory property on hand at the beginning of the year of change must be revalued.

The regulations also provide certain rules that apply to changes in method of accounting for costs subject to section 263A, in addition to the rules and procedures that apply under the applicable revenue procedures. See, §1.263A-7(b).

In addition, the regulations clarify whether certain changes are changes in method of accounting under section 263A and therefore are within the scope of the regulations. For example, a change from one permissible capitalization method, such as the simplified resale method in former §1.263A-1T(d)(4), to another permissible capitalization method, such as the simplified resale method in §1.263A-3(d), is a change in method of accounting under section 263A and is therefore within the scope of the regulations. See §1.263A-7(a)(5).

The final regulations delete certain provisions of §1.263A-7T that were primarily applicable to accounting method changes made in 1987. For example, the final regulations do not incorporate provisions such as §1.263A-7T(e)(2), which provide automatic consent to make the change in method of accounting for the first taxable year section 263A was effective, and §1.263A-7T(e)(7)(iii), (iv) and (v) and §1.263A-7T(e)(8), which provide special rules for adjusting the revaluation factor for costs attributable to different methods of accounting for depreciation (including cost recovery) and differences in the percentage of fixed indirect production costs that were expensed by taxpayers using the practical capacity concept.

Certain Administrative Guidance

The final regulations incorporate the provisions of Notice 88-23 (1988-1 C.B. 490) (ordering rules for accounting method changes), and sections IV (A) (guidance regarding deferred intercompany exchanges) and IV (B) (permission to elect a new base year for taxpayers using the last-in, first-out (LIFO) inventory method) of Notice 88-86 (1988-2 C.B. 401). These notices or portions thereof are withdrawn for taxable years to which this Treasury decision applies.

Effect on other documents

The following publications are obsolete as of August 5, 1997:

Notice 88-23 (1988-1 C.B. 490).

Notice 88-86 (1988-2 C.B. 401), sections IV (A) and IV (B).

Public Comments

The IRS and the Treasury Department received a number of comments in response to the 1987 temporary and proposed regulations. Most of the comments received in response to the temporary regulations issued in March 1987 were considered in connection with the temporary regulations issued in August 1987. In general, those comments are not discussed again here.

REVALUING BEGINNING INVENTORY—THE 3-YEAR AVERAGE METHOD

A. Extending availability of the method

Under the temporary regulations, taxpayers using the dollar-value LIFO inventory method were permitted to use a 3-year average method for revaluing their beginning inventory in the year they changed their method of accounting to comply with section 263A. Several commentators suggested that taxpayers other than those on the dollar-value LIFO inventory method should also be permitted to use this 3-year average method for revaluing beginning inventory in the year of change. Specifically, commentators suggested that the 3-year average method be made available to taxpayers using the specific goods LIFO inventory method. Another suggestion was that taxpayers using the first-in, first-out (FIFO) inven-

tory method should be permitted to use the 3-year average method even though those taxpayers may have sufficient information to revalue their inventory under the facts and circumstances method.

The final regulations do not adopt these suggestions. The House and Senate Reports to the Tax Reform Act of 1986 indicate Congress intended that taxpayers generally revalue their inventory in the year of change using the facts and circumstances method. Because Congress realized that dollar-value LIFO taxpayers may not have the data needed to use the facts and circumstances method, it suggested two other revaluation methods that could be used in conjunction with, or in lieu of, the facts and circumstances method. The 3-year average method was one of those other methods. H.R. Rep. No. 426, 99th Cong., 1st Sess. 633-637 (1985), 1986-3 (Vol. 2) C.B. 633-637 and S. Rep. No. 313, 99th Cong., 2nd Sess. 147-152 (1986), 1986-3 (Vol. 3) C.B. 147-152. The IRS and the Treasury Department believe that limiting the 3-year average method to dollar-value LIFO taxpayers is more consistent with legislative history which expresses Congress' concern that dollar-value LIFO taxpayers may have particular problems in revaluing inventory. H.R. Rep. No. 426, 633, 1986-3 (Vol. 2) C.B. 633 and S. Rep. No. 313, 147, 1986-3 (Vol.3) C.B. 147.

B. Altering the mechanics of the method

One commentator suggested that taxpayers be permitted to revalue items or costs included in beginning inventory in the year of change by using data from the year of change instead of data from the prior three years, and calculate a section 481(a) adjustment accordingly. This commentator further suggested that three years after the year of change, the taxpayer would recompute the section 481(a) adjustment using data from the three new years to test its original adjustment under section 481(a). If the new adjustment were larger than the original adjustment by a substantial amount, the taxpayer would be required to amend its federal income tax returns. The final regulations do not adopt this suggestion. Requiring taxpayers to compute two adjustments under section 481(a) would unnecessarily complicate application of the 3-year average method.

Another commentator suggested that some taxpayers be permitted to revalue items or costs included in beginning inventory in the year of change by using data from the immediately preceding year rather than the prior three years. This proposal to use only the prior year's data would be limited to taxpayers that can show they have not had a significant change in costs over the preceding three years. This suggested modification to the 3-year average method was not adopted. The suggested modification would not substantially simplify the process of revaluing beginning inventory because taxpayers would be required to determine whether their costs significantly changed during the preceding three-year period.

C. Limiting costs subject to revaluation

One commentator suggested that LIFO layers should be revalued only if the items of inventory comprising those layers are still in existence in the year of change. This suggestion was not adopted. However, the final regulations continue the rule in the temporary regulations that taxpayers may adjust the revaluation factor (under either the 3-year average method or the weighted average method) to the extent they can show that additional section 263A costs included in the calculation of the revaluation factor were not incurred in the prior years in which the LIFO layers were accumulated.

D. New base year

Under the 3-year average method, taxpayers generally are required to establish a new base year. Several commentators commented that requiring link-chain LIFO taxpayers to establish a new base year is costly and pointless and suggested that these taxpayers be excluded from the general requirement that all dollar-value LIFO taxpayers establish a new base year. The IRS and the Treasury Department did not adopt this suggestion. If a new base year is not established, the current-year index, determined under the taxpayer's new method of accounting, would be multiplied by the prior-year cumulative index, determined under the taxpayer's former method of accounting, and could distort the taxpayer's LIFO inventory valuation. This distortion is eliminated when the taxpayer establishes a new base year

and establishes a new index. Accordingly, the final regulations provide that all dollar-value LIFO taxpayers (whether using double extension or link-chain) should generally establish a new base year when they use the 3-year average method to revalue their inventories under section 263A.

Commentators also suggested that taxpayers using the 3-year average method and either the simplified production method or the simplified resale method be allowed, but not required, to establish a new base year. Section IV (B) of Notice 88-86 permits these taxpayers to choose whether to establish a new base year. This rule is incorporated into the final regulations.

One commentator noted that the example in the 1987 temporary regulations illustrating the 3-year average method did not use the current year revaluation factor in computing the updated base year cost of inventory. The example has been revised to use the current year revaluation factor.

REVALUING BEGINNING INVENTORY—FACTS AND CIRCUMSTANCES METHOD

One commentator suggested that specific rules or guidelines be adopted to clarify what is a reasonable estimate or procedure for revaluing beginning inventory in connection with a change in method of accounting. This suggestion was not adopted. What is a reasonable estimate or procedure must be decided on a case-by-case basis in light of all applicable facts and circumstances. The final regulations continue the provision in the temporary regulations that permissible estimates and procedures include using information from a more recent period to estimate the amount and nature of inventory costs applicable to earlier periods, and using information with respect to comparable items of inventory to estimate the costs associated with other items of inventory.

NEW BASE YEAR WHEN THE 3-YEAR AVERAGE METHOD IS NOT USED

Several commentators suggested that dollar-value LIFO taxpayers not using the 3-year average method to revalue beginning inventory be permitted to update their base year if they so choose. Section

IV (B) of Notice 88-86 permits these taxpayers to establish a new base year. The final regulations adopt this rule.

SCOPE OF ACCOUNTING METHOD CHANGE

Several commentators suggested that the regulations should allow taxpayers to change from the specific goods LIFO inventory method to the dollar-value LIFO inventory method in connection with changing their method of accounting for costs under section 263A without obtaining the Commissioner's consent. Generally, taxpayers must secure the Commissioner's consent before effecting a change in method of accounting under section 446(e) unless this requirement is specifically waived. The IRS and the Treasury Department do not believe an exception from this general rule is warranted for changes from the specific goods LIFO inventory method to the dollar-value LIFO inventory method except to the extent permitted by §1.472-8(f)(1).

Several commentators also suggested that taxpayers that change their method of accounting for costs subject to section 263A be permitted to make additional changes in their methods of accounting in future tax years under section 263A without obtaining additional consents from the Commissioner. The IRS and the Treasury Department have issued various revenue procedures that provide automatic consent procedures for taxpayers to change their method of accounting for costs under section 263A.

One commentator suggested that the regulations provide that when making the change from the full absorption rules of §1.471-11 to the uniform capitalization rules of section 263A, taxpayers may cease taking into account any costs not treated as inventoriable under section 263A that may have been erroneously inventoried under prior law. The temporary regulations issued in August 1987 and the final regulations permit this result. In revaluing beginning inventory to include additional section 263A costs, taxpayers may cease capitalizing costs that had been capitalized but are not required to be capitalized under section 263A.

AUDIT PROTECTION

Several commentators noted that taxpayers should be guaranteed audit protec-

tion for costs or items that are part of a change in method of accounting under section 263A. The IRS' long-standing administrative position is that if a taxpayer files an application to change its method of accounting in accordance with the applicable administrative guidance, for example, Rev. Proc. 97-27, an examining agent may not later propose that the taxpayer change its method of accounting for the same item for a taxable year prior to the year of change.

ORDERING RULES

One commentator suggested that overall accounting method changes (for example, the cash receipts and disbursements method to an accrual method) should be implemented prior to any change in method of accounting for costs under section 263A. The temporary regulations generally provide that a change in method of accounting for costs under section 263A is deemed to occur prior to any other change in method of accounting effected during the year of change. The final regulations continue that general rule with four modifications. Taxpayers that are discontinuing the LIFO inventory method may make that change prior to a change in method of accounting under section 263A. Additionally, taxpayers that are changing from the specific goods LIFO inventory method to the dollar-value LIFO inventory method may make that change prior to a change in method of accounting under section 263A. Also, taxpayers that are changing their overall method of accounting from the cash method to an accrual method must make the change to an accrual method prior to a change in method of accounting under section 263A. Finally, taxpayers that are changing their method of accounting for depreciation when any portion of the depreciation is subject to section 263A must make the method change for depreciation prior to a change in method of accounting under section 263A.

COST ALLOCATION METHOD

Several commentators suggested that the regulations be clarified to provide that a taxpayer must use the same cost allocation method to restate its beginning inventory and to value its ongoing inventory. The final regulations clarify this point. Inventory on hand at the beginning of the

- (ii) Deemed avoidance of this section.
- (A) Scope.
- (B) General rule.
- (iii) Election to use transferor's LIFO layers.
- (iv) Tax avoidance intent not required.
- (v) Related corporation.
- (d) Non-inventory property.
- (1) Need for adjustments.
- (2) Revaluing property.

§1.263A-1 [Amended]

Par. 3. Section 1.263A-1 is amended by removing "1.263A-7T (e) generally" from the last sentence in paragraph (a)(2)(i) and replacing it with "1.263A-7".

Par. 4. Section 1.263A-7 is added to read as follows:

§1.263A-7 Changing a method of accounting under section 263A.

(a) *Introduction*—(1) *Purpose*. These regulations provide guidance to taxpayers changing their methods of accounting for costs subject to section 263A. The principal purpose of these regulations is to provide guidance regarding how taxpayers are to revalue property on hand at the beginning of the taxable year in which they change their method of accounting for costs subject to section 263A. Paragraph (c) of this section provides guidance regarding how items or costs included in beginning inventory in the year of change must be revalued. Paragraph (d) of this section provides guidance regarding how non-inventory property should be revalued in the year of change.

(2) *Taxpayers that adopt a method of accounting under section 263A*. Taxpayers may adopt a method of accounting for costs subject to section 263A in the first taxable year in which they engage in resale or production activities. For purposes of this section, the adoption of a method of accounting has the same meaning as provided in §1.446-1(e)(1). Taxpayers are not subject to the provisions of these regulations to the extent they adopt, as opposed to change, a method of accounting.

(3) *Taxpayers that change a method of accounting under section 263A*. Taxpayers changing their method of accounting for costs subject to section 263A are subject to the revaluation and other provisions of this section. Taxpayers subject to

these regulations include, but are not limited to—

(i) Resellers of personal property whose average annual gross receipts for the immediately preceding 3-year period (or lesser period if the taxpayer was not in existence for the three preceding taxable years) exceed \$10,000,000 where the taxpayer was not subject to section 263A in the prior taxable year;

(ii) Resellers of real or personal property that are using a method that fails to comply with section 263A and desire to change to a method of accounting that complies with section 263A;

(iii) Producers of real or tangible personal property that are using a method that fails to comply with section 263A and desire to change to a method of accounting that complies with section 263A; and

(iv) Resellers and producers that desire to change from one permissible method of accounting for costs subject to section 263A to another permissible method.

(4) *Effective date*. The provisions of this section are effective for taxable years beginning on or after August 5, 1997. For taxable years beginning before August 5, 1997, the rules of §1.263A-7T contained in the 26 CFR part 1 edition revised as of April 1, 1997, as modified by other administrative guidance, will apply.

(5) *Definition of change in method of accounting*. For purposes of this section, a change in method of accounting has the same meaning as provided in §1.446-1(e)(2)(ii). Changes in method of accounting for costs subject to section 263A include changes to methods required or permitted by section 263A and the regulations thereunder. Changes in method of accounting may be described in the preceding sentence irrespective of whether the taxpayer's previous method of accounting resulted in the capitalization of more (or fewer) costs than the costs required to be capitalized under section 263A and the regulations thereunder, and irrespective of whether the taxpayer's previous method of accounting was a permissible method under the law in effect when the method was being used. However, changes in method of accounting for costs subject to section 263A do not include changes relating to factors other than those described therein. For example, a change in method of accounting for costs subject to section 263A does not in-

clude a change from one inventory identification method to another inventory identification method, such as a change from the last-in, first-out (LIFO) method to the first-in, first-out (FIFO) method, or vice versa, or a change from one inventory valuation method to another inventory valuation method under section 471, such as a change from valuing inventory at cost to valuing the inventory at cost or market, whichever is lower, or vice versa. In addition, a change in method of accounting for costs subject to section 263A does not include a change within the LIFO inventory method, such as a change from the double extension method to the link-chain method, or a change in the method used for determining the number of pools. Further, a change from the modified resale method set forth in Notice 89-67 (1989-1 C.B. 723), see §601.601(d)(2) of this chapter, to the simplified resale method set forth in §1.263A-3(d) is not a change in method of accounting within the meaning of §1.446-1(e)(2)(ii) and is therefore not subject to the provisions of this section. However, a change from the simplified resale method set forth in former §1.263A-1T(d)(4) to the simplified resale method set forth in §1.263A-3(d) is a change in method of accounting within the meaning of §1.446-1(e)(2)(ii) and is subject to the provisions of this section.

(b) *Rules applicable to a change in method of accounting*—(1) *General rules*. All changes in method of accounting for costs subject to section 263A are subject to the rules and procedures provided by the Code, regulations, and administrative procedures applicable to such changes. The Internal Revenue Service has issued specific revenue procedures that govern certain accounting method changes for costs subject to section 263A. Where a specific revenue procedure is not applicable, changes in method of accounting for costs subject to section 263A are subject to the same rules and procedures that govern other accounting method changes. See Rev. Proc. 97-27 (1997-21 I.R.B. 10) and §601.601(d)(2) of this chapter.

(2) *Special rules*—(i) *Ordering rules when multiple changes in method of accounting occur in the year of change*.

(A) *In general*. A change in method of accounting for costs subject to section 263A is generally deemed to occur (in-

cluding the computation of the adjustment under section 481(a)) before any other change in method of accounting is deemed to occur for that same taxable year.

(B) *Exceptions to the general ordering rule*—(1) *Change from the LIFO inventory method.* In the case of a taxpayer that is discontinuing its use of the LIFO inventory method in the same taxable year it is changing its method of accounting for costs subject to section 263A, the change from the LIFO method may be made before the change in method of accounting (and the computation of the corresponding adjustment under section 481(a)) under section 263A is made.

(2) *Change from the specific goods LIFO inventory method.* In the case of a taxpayer that is changing from the specific goods LIFO inventory method to the dollar-value LIFO inventory method in the same taxable year it is changing its method of accounting for costs subject to section 263A, the change from the specific goods LIFO inventory method may be made before the change in method of accounting under section 263A is made.

(3) *Change in overall method of accounting.* In the case of a taxpayer that is changing its overall method of accounting from the cash receipts and disbursements method to an accrual method in the same taxable year it is changing its method of accounting for costs subject to section 263A, the taxpayer must change to an accrual method for capitalizable costs (see §1.263A-1(c)(2)(ii)) before the change in method of accounting (and the computation of the corresponding adjustment under section 481(a)) under section 263A is made.

(4) *Change in method of accounting for depreciation.* In the case of a taxpayer that is changing its method of accounting for depreciation in the same taxable year it is changing its method of accounting for costs subject to section 263A and any portion of the depreciation is subject to section 263A, the change in method of accounting for depreciation must be made before the change in method of accounting (and the computation of the corresponding adjustment under section 481(a)) under section 263A is made.

(ii) *Adjustment required by section 481(a).* In the case of any taxpayer required or permitted to change its method

of accounting for any taxable year under section 263A and the regulations thereunder, the change will be treated as initiated by the taxpayer for purposes of the adjustment required by section 481(a). The adjustment required by section 481(a) is to be taken into account in computing taxable income over a period not to exceed 4 taxable years.

(iii) *Base year*—(A) *Need for a new base year.* Certain dollar-value LIFO taxpayers (whether using double extension or link-chain) must establish a new base year when they revalue their inventories under section 263A.

(1) *Facts and circumstances revaluation method used.* A dollar-value LIFO taxpayer that uses the facts and circumstances revaluation method is permitted, but not required, to establish a new base year.

(2) *3-year average method used*—(i) *Simplified method not used.* A dollar-value LIFO taxpayer using the 3-year average method but not the simplified production method or the simplified resale method to revalue its inventory is required to establish a new base year.

(ii) *Simplified method used.* A dollar-value LIFO taxpayer using the 3-year average method and either the simplified production method or the simplified resale method to revalue its inventory is permitted, but not required, to establish a new base year.

(B) *Computing a new base year.* For purposes of determining future indexes, the year of change becomes the new base year (that is, the index at the beginning of the year of change generally must be 1.00) and all costs are restated in new base year costs for purposes of extending such costs in future years. However, when a new base year is established, costs associated with old layers retain their separate identity within the base year, with such layers being restated in terms of the new base year index. For example, for purposes of determining whether a particular layer has been invaded, each layer must retain its separate identity. Thus, if a decrement in an inventory pool occurs, layers accumulated in more recent years must be viewed as invaded first, in order of priority.

(C) *Inventory*—(1) *Need for adjustments.* When a taxpayer changes its method of accounting for costs subject to

section 263A, the taxpayer generally must, in computing its taxable income for the year of change, take into account the adjustments required by section 481(a). The adjustments required by section 481(a) relate to revaluations of inventory property, whether the taxpayer produces the inventory or acquires it for resale. See paragraph (d) of this section in regard to the adjustments required by section 481(a) that relate to non-inventory property.

(2) *Revaluing beginning inventory*—(i) *In general.* If a taxpayer changes its method of accounting for costs subject to section 263A, the taxpayer must revalue the items or costs included in its beginning inventory in the year of change as if the new method (that is, the method to which the taxpayer is changing) had been in effect during all prior years. In revaluing inventory costs under this procedure, all of the capitalization provisions of section 263A and the regulations thereunder apply to all inventory costs accumulated in prior years. The necessity to revalue beginning inventory as if these capitalization rules had been in effect for all prior years includes, for example, the revaluation of costs or layers incurred in taxable years preceding the transition period to the full absorption method of inventory costing as described in §1.471-11(e), regardless of whether a taxpayer employed a cut-off method under those regulations. The difference between the inventory as originally valued using the former method (that is, the method from which the taxpayer is changing) and the inventory as revalued using the new method is equal to the amount of the adjustment required under section 481(a).

(ii) *Methods to revalue inventory.* There are three methods available to revalue inventory. The first method, the facts and circumstances revaluation method, may be used by all taxpayers. Under this method, a taxpayer determines the direct and indirect costs that must be assigned to each item of inventory based on all the facts and circumstances. This method is described in paragraph (c)(2)(iii) of this section. The second method, the weighted average method, is available only in certain situations to taxpayers using the FIFO inventory method or the specific goods LIFO inventory method. This method is described in paragraph (c)(2)(iv) of this section. The

third method, the 3-year average method, is available to all taxpayers using the dollar-value LIFO inventory method of accounting. This method is described in paragraph (c)(2)(v) of this section. The weighted average method and the 3-year average method revalue inventory through processes of estimation and extrapolation, rather than based on the facts and circumstances of a particular year's data. All three methods are available regardless of whether the taxpayer elects to use a simplified method to capitalize costs under section 263A.

(iii) *Facts and circumstances revaluation method*—(A) *In general.* Under the facts and circumstances revaluation method, a taxpayer generally is required to revalue inventories by applying the capitalization rules of section 263A and the regulations thereunder to the production and resale activities of the taxpayer, with the same degree of specificity as required of inventory manufacturers under the law immediately prior to the effective date of the Tax Reform Act of 1986 (Public Law 99-514, 100 Stat. 2085, 1986-3 C.B. (Vol. 1)). Thus, for example, with respect to any prior year that is relevant in determining the total amount of the revalued balance as of the beginning of the year of change, the taxpayer must analyze the production and resale data for that particular year and apply the rules and principles of section 263A and the regulations thereunder to determine the appropriate revalued inventory costs. However, under the facts and circumstances revaluation method, a taxpayer may utilize reasonable estimates and procedures in valuing inventory costs if—

(1) The taxpayer lacks, and is not able to reconstruct from its books and records, actual financial and accounting data which is required to apply the capitalization rules of section 263A and the regulations thereunder to the relevant facts and circumstances surrounding a particular item of inventory or cost; and

(2) The total amounts of costs for which reasonable estimates and procedures are employed are not significant in comparison to the total restated value (including costs previously capitalized under the taxpayer's former method) of the items or costs for the period in question.

(B) *Exception.* A taxpayer that is not able to comply with the requirement of

paragraph (c)(2)(iii)(A)(2) of this section because of the existence of a significant amount of costs that would require the use of estimates and procedures must revalue its inventories under the procedures provided in paragraph (c)(2)(iv) or (v) of this section.

(C) *Estimates and procedures allowed.* The estimates and procedures of this paragraph (c)(2)(iii) include—

(1) The use of available information from more recent years to estimate the amount and nature of inventory costs applicable to earlier years; and

(2) The use of available information with respect to comparable items of inventory produced or acquired during the same year in order to estimate the costs associated with other items of inventory.

(D) *Use by dollar-value LIFO taxpayers.* Generally, a dollar-value LIFO taxpayer must recompute its LIFO inventory for each taxable year that the LIFO inventory method was used.

(E) *Examples.* The provisions of this paragraph (c)(2)(iii) are illustrated by the following three examples. The principles set forth in these examples are applicable both to production and resale activities and the year of change in all three examples is 1997. The examples read as follows:

Example 1. Taxpayer X lacks information for the years 1993 and earlier, regarding the amount of costs incurred in transporting finished goods from X's factory to X's warehouse and in storing those goods at the warehouse until their sale to customers. X determines that, for 1994 and subsequent years, these transportation and storage costs constitute 4 percent of the total costs of comparable goods under X's method of accounting for such years. Under this paragraph (c)(2)(iii), X may assume that transportation and storage costs for the years 1993 and earlier constitute 4 percent of the total costs of such goods.

Example 2. Assume the same facts as in *Example 1*, except that for the year 1993 and earlier, X used a different method of accounting for inventory costs whereunder significantly fewer costs were capitalized than amounts capitalized in later years. Thus, the application of transportation and storage based on a percentage of costs for 1994 and later years would not constitute a reasonable estimate for use in earlier years. X may use the information from 1994 and later years, if appropriate adjustments are made to reflect the differences in inventory costs for the applicable years, including, for example—

(i) Increasing the percentage of costs that are intended to represent transportation and storage costs to reflect the aggregate differences in capitalized amounts under the two methods of accounting; or

(ii) Taking the absolute dollar amount of transportation and storage costs for comparable goods in inventory and applying that amount (adjusted for changes in general price levels, where appropriate) to goods associated with 1993 and prior periods.

Example 3. Taxpayer Z lacks information for certain years with respect to factory administrative costs, subject to capitalization under section 263A

and the regulations thereunder, incurred in the production of inventory in factory A. Z does have sufficient information to determine factory administrative costs with respect to production of inventory in factory B, wherein inventory items were produced during the same years as factory A. Z may use the information from factory B to determine the appropriate amount of factory administrative costs to capitalize as inventory costs for comparable items produced in factory A during the same years.

(iv) *Weighted average method*—(A) *In general.* A taxpayer using the FIFO method or the specific goods LIFO method of accounting for inventories may use the weighted average method as provided in this paragraph (c)(2)(iv) to estimate the change in the amount of costs that must be allocated to inventories for prior years. The weighted average method under this paragraph (c)(2)(iv) is only available to a taxpayer that lacks sufficient data to revalue its inventory costs under the facts and circumstances revaluation method provided for in paragraph (c)(2)(iii) of this section. Moreover, a taxpayer that qualifies for the use of the weighted average method under this paragraph (c)(2)(iv) must utilize such method only with respect to items or costs for which it lacks sufficient information to revalue under the facts and circumstances revaluation method. Particular items or costs must be revalued under the facts and circumstances revaluation method if sufficient information exists to make such a revaluation. If a taxpayer lacks sufficient information to otherwise apply the weighted average method under this paragraph (c)(2)(iv) (for example, the taxpayer is unable to revalue the costs of any of its items in inventory due to a lack of information), then the taxpayer must use reasonable estimates and procedures, as described in the facts and circumstances revaluation method, to whatever extent is necessary to allow the taxpayer to apply the weighted average method.

(B) *Weighted average method for FIFO taxpayers*—(1) *In general.* This paragraph (c)(2)(iv)(B) sets forth the mechanics of the weighted average method as applicable to FIFO taxpayers. Under the weighted average method, an item in ending inventory for which sufficient data is not available for revaluation under section 263A and the regulations thereunder must be revalued by using the weighted average percentage increase or decrease with respect to such item for the earliest subsequent taxable year for which suffi-

cient data is available. With respect to an item for which no subsequent data exists, such item must be revalued by using the weighted average percentage increase or decrease with respect to all reasonably comparable items in the taxpayer's inventory for the same year or the earliest subsequent taxable year for which sufficient data is available.

(2) *Example.* The provisions of this paragraph (c)(2)(iv)(B) are illustrated by the following example. The principles set forth in this example are applicable both to production and resale activities and the year of change in the example is 1997. The example reads as follows:

Example. Taxpayer A manufactures bolts and uses the FIFO method to identify inventories. Under A's former method, A did not capitalize all of the costs required to be capitalized under section 263A. A maintains inventories of bolts, two types of which it no longer produces. Bolt A was last produced in 1994. The revaluation of the costs of Bolt A under this section for bolts produced in 1994 results in a 20 percent increase of the costs of Bolt A. A portion of the inventory of Bolt A, however, is attributable to 1993. A does not have sufficient data for revaluation of the 1993 cost for Bolt A. With respect to Bolt A, A may apply the 20 percent increase determined for 1994 to the 1993 production as an acceptable estimate. Bolt B was last produced in 1992 and no data exists that would allow revaluation of the inventory cost of Bolt B. The inventories of all other bolts for which information is available are attributable to 1994 and 1995. Revaluation of the costs of these other bolts using available data results in an average increase in inventory costs of 15 percent for 1994 production. With respect to Bolt B, the overall 15 percent increase for A's inventory for 1994 may be used in revaluing the cost of Bolt B.

(C) *Weighted average method for specific goods LIFO taxpayers—(1) In general.* This paragraph (c)(2)(iv)(C) sets forth the mechanics of the weighted average method as applicable to LIFO taxpayers using the specific goods method of valuing inventories. Under the weighted average method, the inventory layers with respect to an item for which data is available are revalued under this section and the increase or decrease in amount for each layer is expressed as a percentage of change from the cost in the layer as originally valued. A weighted average of the percentage of change for all layers for each type of good is computed and applied to all earlier layers for each type of good that lack sufficient data to allow for revaluation. In the case of earlier layers for which sufficient data exists, such layers are to be revalued using actual data. In cases where sufficient data is not available to make a weighted average estimate

with respect to a particular item of inventory, a weighted average increase or decrease is to be determined using all other inventory items revalued by the taxpayer in the same specific goods grouping. This percentage increase or decrease is then used to revalue the cost of the item for which data is lacking. If the taxpayer lacks sufficient data to revalue any of the inventory items contained in a specific goods grouping, then the weighted average increase or decrease of substantially similar items (as determined by principles similar to the rules applicable to dollar-value LIFO taxpayers in §1.472-8(b)(3)) must be applied in the revaluation of the items in such grouping. If insufficient data exists with respect to all the items in a specific goods grouping and to all items that are substantially similar (or such items do not exist), then the weighted average for all revalued items in the taxpayer's inventory must be applied in revaluing items for which data is lacking.

(2) *Example.* The provisions of this paragraph (c)(2)(iv)(C) are illustrated by the following example. The principles set forth in this example are applicable both to production and resale activities and the year of change in the example is 1997. The example reads as follows:

Example. (i) Taxpayer M is a manufacturer that produces two different parts. Under M's former method, M did not capitalize all of the costs required to be capitalized under section 263A. Work-in-process inventory is recorded in terms of equivalent units of finished goods. M's records show the following at the end of 1996 under the specific goods LIFO inventory method:

LIFO			
Product and layer	Number	Cost	Carrying values
Product #1:			
1993	150	\$5.00	\$750
1994	100	6.00	600
1995	100	6.50	650
1996	50	7.00	350
			\$2,350
Product #2:			
1993	200	\$4.00	\$800
1994	200	4.50	900
1995	100	5.00	500
1996	100	6.00	600
			\$2,800

Total carrying value of Products #1 and #2 under M's former method \$5,150

(ii) M has sufficient data to revalue the unit costs of Product #1 using its new method for 1994, 1995 and 1996. These costs are: \$7.00 in 1994, \$7.75 in 1995, and \$9.00 in 1996. This data for Product #1 results in a weighted average percentage change of 20.31 percent $[(100 \times (\$7.00 - \$6.00)) + (100 \times (\$7.75 - \$6.50)) + (50 \times (\$9.00 - \$7.00))] \div (100 \times \$6.00) + (100 \times \$6.50) + (50 \times \$7.00)]$. M has sufficient data to revalue the unit costs of Product #2 only in 1995 and 1996. These costs are: \$6.00 in 1995 and \$7.00 in 1996. This data for Product #2 results in a weighted average percentage change of 18.18 percent $[(100 \times (\$6.00 - \$5.00)) + (100 \times (\$7.00 - \$6.00))] \div (100 \times \$5.00) + (100 \times \$6.00)]$.

(iii) M can estimate its revalued costs for Product #1 for 1993 by applying the weighted average increase computed for Product #1 (20.31 percent) to the unit costs originally carried on M's records for 1993 under M's former method. The estimated revalued unit cost of Product #1 would be \$6.02 $(\$5.00 \times 1.2031)$. M estimates its revalued costs for Product #2 for 1993 and 1994 in a similar fashion. M applies the weighted average increase determined for Product #2 (18.18 percent) to the unit costs of \$4.00 and \$4.50 for 1993 and 1994 respectively. The revalued unit costs of Product #2 are \$4.73 for 1993 $(\$4.00 \times 1.1818)$ and \$5.32 for 1994 $(\$4.50 \times 1.1818)$.

(iv) M's inventory would be revalued as follows:

LIFO			
Product and layer	Number	Cost	Carrying values
Product #1:			
1993	150	\$6.02	\$903
1994	100	7.00	700
1995	100	7.75	775
1996	50	9.00	450
			\$2,828
Product #2:			
1993	200	\$4.73	\$946
1994	200	5.32	1,064
1995	100	6.00	600
1996	100	7.00	700
			\$3,310

Total value of Products #1 and #2 as revalued under M's new method \$6,138

Total amount of adjustment required under section 481(a) $[\$6,138 - \$5,150]$ \$988

(D) *Adjustments to inventory costs from prior years.* For special rules applicable when a revaluation using the weighted average method includes costs not incurred in prior years, see paragraph (c)(2)(v)(E) of this section.

(v) *3-year average method—(A) In general.* A taxpayer using the dollar-value LIFO method of accounting for inventories may revalue all existing LIFO layers of a trade or business based on the 3-year average method as provided in this paragraph (c)(2)(v). The 3-year average method is based on the average percentage change (the 3-year revaluation factor) in the current costs of inventory for each LIFO pool based on the three most recent taxable years for which the taxpayer has sufficient information (typically, the three most recent taxable years of such trade or business). The 3-year revaluation factor is applied to all layers for each pool in beginning inventory in the year of change. The 3-year average method is available to

any dollar-value taxpayer that complies with the requirements of this paragraph (c)(2)(v) regardless of whether such taxpayer lacks sufficient data to revalue its inventory costs under the facts and circumstances revaluation method prescribed in paragraph (c)(2)(iii) of this section. The 3-year average method must be applied with respect to all inventory in a taxpayer's trade or business. A taxpayer is not permitted to apply the method for the revaluation of some, but not all, inventory costs on the basis of pools, business units, or other measures of inventory amounts that do not constitute a separate trade or business. Generally, a taxpayer revaluing its inventory using the 3-year average method must establish a new base year. See, paragraph (b)(2)(iii)(A)(2)(i) of this section. However, a dollar-value LIFO taxpayer using the 3-year average method and either the simplified production method or the simplified resale method to revalue its inventory is permitted, but not required, to establish a new base year. See, paragraph (b)(2)(iii)(A)(2)(ii) of this section. If a taxpayer lacks sufficient information to otherwise apply the 3-year average method under this paragraph (c)(2)(v) (for example, the taxpayer is unable to revalue the costs of any of its LIFO pools for three years due to a lack of information), then the taxpayer must use reasonable estimates and procedures, as described in the facts and circumstances revaluation method under paragraph (c)(2)(iii) of this section, to whatever extent is necessary to allow the taxpayer to apply the 3-year average method.

(B) *Consecutive year requirement.* Under the 3-year average method, if sufficient data is available to calculate the revaluation factor for more than three years, the taxpayer may use data from such additional years in determining the average percentage increase or decrease only if the additional years are consecutive to and prior to the year of change. The requirement under the preceding sentence to use consecutive years is applicable under this method regardless of whether any inventory costs in beginning inventory as of the year of change are viewed as incurred in, or attributable to, those consecutive years under the LIFO inventory method. Thus, the requirement to use data from consecutive years may

result in using information from a year in which no LIFO increment occurred. For example, if a taxpayer is changing its method of accounting in 1997 and has sufficient data to revalue its inventory for the years 1991 through 1996, the taxpayer may calculate the revaluation factor using all six years. If, however, the taxpayer has sufficient data to revalue its inventory for the years 1990 through 1992, and 1994 through 1996, only the three years consecutive to the year of change, that is, 1994 through 1996, may be used in determining the revaluation factor. Similarly, for example, a taxpayer with LIFO increments in 1995, 1993, and 1992 may not calculate the revaluation factor based on the data from those years alone, but instead must use the data from consecutive years for which the taxpayer has information.

(C) *Example.* The provisions of this paragraph (c)(2)(v) are illustrated by the following example. The principles set forth in this example are applicable both to production and resale activities and the year of change in the example is 1997. The example reads as follows:

Example. (i) Taxpayer G, a calendar year taxpayer, is a reseller that is required to change its method of accounting under section 263A. G will not use either the simplified production method or the simplified resale method. G adopted the dollar-value LIFO inventory method in 1991, using a single pool and the double extension method. G's beginning LIFO inventory as of January 1, 1997, computed using its former method, for the year of change is as follows:

	Base year costs	Index	LIFO carrying value
Base layer . . .	\$14,000	1.00	\$14,000
1991 layer	4,000	1.20	4,800
1992 layer	5,000	1.30	6,500
1993 layer	2,000	1.35	2,700
1994 layer	0	1.40	0
1995 layer	4,000	1.50	6,000
1996 layer	5,000	1.60	8,000
Total	\$34,000	\$42,000

(ii) G is able to recompute total inventoriable costs incurred under its new method for the three preceding taxable years as follows:

	Current cost as recorded (former method)	Current cost as adjusted (new method)	Percentage change
1994	\$35,000	\$45,150	.29
1995	43,500	54,375	.25
1996	54,400	70,720	.30
Total	\$132,900	\$170,245	.28

(iii) Applying the average revaluation factor of .28 to each layer, G's inventory is restated as follows:

	Restated base year costs	Index	Restated LIFO carrying value
Base layer . . .	\$17,920	1.00	\$17,920
1991 layer	5,120	1.20	6,144
1992 layer	6,400	1.30	8,320
1993 layer	2,560	1.35	3,456
1994 layer	0	1.40	0
1995 layer	5,120	1.50	7,680
1996 layer	6,400	1.60	10,240
Total	\$43,520	\$53,760

(iv) The adjustment required by section 481(a) is \$11,760. This amount may be computed by multiplying the average percentage of .28 by the LIFO carrying value of G's inventory valued using its former method (\$42,000). Alternatively, the adjustment required by section 481(a) may be computed by the difference between—

(A) The restated costs of the taxpayer's inventory under its new method (\$53,760), and

(B) The costs of the taxpayer's inventory using its former method (\$42,000).

(v) In addition, the inventory as of the first day of the year of change (January 1, 1997) becomes the new base year cost for purposes of determining the LIFO index in future years. See, paragraphs (b)(2)(iii)(A)(2)(i) and (b)(2)(iii)(B) of this section. This requires that layers in years prior to the base year be restated in terms of the new base year index. The current year cost of G's inventory, as adjusted, is \$70,720. Such cost must be apportioned to each layer in proportion to the restated base year cost of that layer to total restated base year costs (\$43,520), as follows:

	Restated base year costs	Restated index	Restated LIFO carrying value
Old base layer \$29,120		.615	\$17,920
1991 layer	8,320	.738	6,144
1992 layer	10,400	.80	8,320
1993 layer	4,160	.831	3,456
1994 layer	0	—	0
1995 layer	8,320	.923	7,680
1996 layer	10,400	.985	10,240
Total	\$70,720	\$53,760

(D) *Short taxable years.* A short taxable year is treated as a full 12 months.

(E) *Adjustments to inventory costs from prior years—(1) General rule—(i)* The use of the revaluation factor, based on current costs, to estimate the revaluation of prior inventory layers under the 3-year average method, as described in paragraph (c)(2)(v) of this section, may result in an allocation of costs that include amounts attributable to costs not incurred during the year in which the layer arose. To the extent a taxpayer can demonstrate that costs that contributed to the determination of the revaluation factor could not have affected a prior year, the revaluation factor as applied to that year may be adjusted under the restatement adjustment procedure, as described in paragraph (c)(2)(v)(F) of this section. The determination that a cost could not have affected

a prior year must be made by a taxpayer only upon showing that the type of cost incurred during the years used to calculate the revaluation factor (revaluation years) was not present during such prior year. An item of cost will not be eligible for the restatement adjustment procedure simply because the cost varies in amount from year to year or the same type of cost is described or referred to by a different name from year to year. Thus, the restatement adjustment procedure allowed under paragraph (c)(2)(v)(F) of this section is not available in a prior year with respect to a particular cost if the same type of cost was incurred both in the revaluation years and in such prior year, although the amount of such cost and the name or description thereof may vary.

(ii) The provisions of this paragraph (c)(2)(v)(E) are also applicable to taxpayers using the weighted average method in revaluing inventories under paragraph (c)(2)(iv) of this section. Thus, to the extent a taxpayer can demonstrate that costs that contributed to the determination of the restatement of a particular year or item could not have affected a prior year or item, the taxpayer may adjust the revaluation of that prior year or item accordingly under the weighted average method. All the requirements and definitions, however, applicable to the restatement adjustment procedure under this paragraph (c)(2)(v)(E) fully apply to a taxpayer using the weighted average method to revalue inventories.

(2) *Examples of costs eligible for restatement adjustment procedure.* The provisions of this paragraph (c)(2)(v)(E) are illustrated by the following four examples. The principles set forth in these examples are applicable both to production and resale activities and the year of change in the four examples is 1997. The examples read as follows:

Example 1. Taxpayer A is a reseller that introduced a defined benefit pension plan in 1994, and made the plan available to personnel whose labor costs were (directly or indirectly) properly allocable to resale activities. A determines the revaluation factor based on data available for the years 1994 through 1996, for which the pension plan was in existence. Based on these facts, the costs of the pension plan in the revaluation years are eligible for the restatement adjustment procedure for years prior to 1994.

Example 2. Assume the same facts as in *Example 1*, except that a defined contribution plan was available, during prior years, to personnel whose labor costs were properly allocable to resale activities. The defined contribution plan was terminated before

the introduction of the defined benefit plan in 1994. Based on these facts, the costs of the defined benefit pension plan in the revaluation years are not eligible for the restatement adjustment procedure with respect to years for which the defined contribution plan existed.

Example 3. Taxpayer C is a manufacturer that established a security department in 1995 to patrol and safeguard its production and warehouse areas used in C's trade or business. Prior to 1995, C had not been required to utilize security personnel in its trade or business; C established the security department in 1995 in response to increasing vandalism and theft at its plant locations. Based on these facts, the costs of the security department are eligible for the restatement adjustment procedure for years prior to 1995.

Example 4. Taxpayer D is a reseller that established a payroll department in 1995 to process the company's weekly payroll. In the years 1991 through 1994, D engaged the services of an outside vendor to process the company's payroll. Prior to 1991, D's payroll processing was done by D's accounting department, which was responsible for payroll processing as well as for other accounting functions. Based on these facts, the costs of the payroll department are not eligible for the restatement adjustment procedure. D was incurring the same type of costs in earlier years as D was incurring in the payroll department in 1995 and subsequent years, although these costs were designated by a different name or description.

(F) *Restatement adjustment procedure—(1) In general—(i)* This paragraph (c)(2)(v)(F) provides a restatement adjustment procedure whereunder a taxpayer may adjust the restatement of inventory costs in prior taxable years in order to produce a different restated value than the value that would otherwise occur through application of the revaluation factor to such prior taxable years.

(ii) Under the restatement adjustment procedure as applied to a particular prior year, a taxpayer must determine the particular items of cost that are eligible for the restatement adjustment with respect to such prior year. The taxpayer must then recompute, using reasonable estimates and procedures, the total inventoriable costs that would have been incurred for each revaluation year under the taxpayer's former method and the taxpayer's new method by making appropriate adjustments in the data for such revaluation year to reflect the particular costs eligible for adjustment.

(iii) The taxpayer must then compute the total percentage change with respect to each revaluation year, using the revised estimates of total inventoriable costs for such year as described in paragraph (c)(2)(v)(F)(1)(ii) of this section. The percentage change must be determined by calculating the ratio of the revised total of

the inventoriable costs for such revaluation year under the taxpayer's new method to the revised total of the inventoriable costs for such revaluation year under the taxpayer's former method.

(iv) An average of the resulting percentage change for all revaluation years is then calculated, and the resulting average is applied to the prior year in issue.

(2) *Examples of restatement adjustment procedure.* The provisions of this paragraph (c)(2)(v)(F) are illustrated by the following two examples. The principles set forth in these examples are applicable both to production and resale activities and the year of change in the two examples is 1997. The examples read as follows:

Example 1. Taxpayer A is a reseller that is eligible to make a restatement adjustment by reason of the costs of a defined benefit pension plan that was introduced in 1994, during the revaluation period. The revaluation factor, before adjustment of data to reflect the pension costs, is as provided in the example in paragraph (c)(2)(v)(C) of this section. Thus, for example, with respect to the year 1994, the total inventoriable costs under A's former method is \$35,000, the total inventoriable costs under A's new method is \$45,150, and the percentage change is .29. Under the method of accounting used by A during 1994 (the former method), none of the pension costs were included as inventoriable costs. Thus, under the restatement adjustment procedure, the total inventoriable cost under A's former method would remain at \$35,000 if the pension plan had not been in existence. Similarly, A determines that the total inventoriable costs for 1994 under A's new method, if the pension plan had not been in existence, would have been \$42,000. The restatement adjustment for 1994 determined under this paragraph (c)(2)(v)(F) would then be equal to .20 $(\$42,000 - \$35,000)/\$35,000$. A would make similar calculations with respect to 1995 and 1996. The average of such amounts for each of the three years in the revaluation period would then be determined as in the example in paragraph (c)(2)(v)(C) of this section. Such average would be used to revalue cost layers for years for which the pension plan was not in existence. Such revalued layers would then be viewed as restated in compliance with the requirements of this paragraph. With respect to cost layers incurred during years for which the pension plan was in existence, no adjustment of the revaluation factor would occur.

Example 2. Assume the same facts as in *Example 1*, except that a portion of the pension costs were included as inventoriable costs under the method used by A during 1994 (the former method). Under the restatement adjustment procedure, A determines that the total inventoriable costs for 1994 under the former method, if the pension plan had not been in existence, would have been \$34,000. Similarly, A determines that the total inventoriable costs for 1994 under A's new method, if the pension plan had not been in existence, would have been \$42,000. The restatement adjustment for 1994 determined under this paragraph (c)(2)(v)(F) would then be equal to .24 $(\$42,000 - \$34,000)/\$34,000$. A would make similar calculations with respect to 1995 and 1996. The average of such amounts for each of the three years in the revaluation period would then be determined as in the example in paragraph (c)(2)(v)(C) of this section. Such average would be used to revalue

cost layers for years for which the pension plan was not in existence.

(3) *Intercompany items*—(i) *Revaluing intercompany transactions.* Pursuant to any change in method of accounting for costs subject to section 263A, taxpayers are required to revalue the amount of any intercompany item resulting from the sale or exchange of inventory property in an intercompany transaction to an amount equal to the intercompany item that would have resulted had the cost of goods sold for that inventory property been determined under the taxpayer's new method. The requirement of the preceding sentence applies with respect to both inventory produced by a taxpayer and inventory acquired by the taxpayer for resale. In addition, the requirements of this paragraph (c)(3) apply only to any intercompany item of the taxpayer as of the beginning of the year of change in method of accounting. See §1.1502–13(b)(2)(ii). A taxpayer must revalue the amount of any intercompany item only if the inventory property sold in the intercompany transaction is held as inventory by a buying member as of the date the taxpayer changes its method of accounting under section 263A. Corresponding changes to the adjustment required under section 481(a) must be made with respect to any adjustment of the intercompany item required under this paragraph (c)(3). Moreover, the requirements of this paragraph (c)(3) apply regardless of whether the taxpayer has any items in beginning inventory as of the year of change in method of accounting. See §1.1502–13 for the definition of intercompany transaction.

(ii) *Example.* The provisions of this paragraph (c)(3) are illustrated by the following example. The principles set forth in this example are applicable both to production and resale activities and the year of change in the example is 1997. The example reads as follows:

Example. (i) Assume that S, a member of a consolidated group filing its federal income tax return on a calendar year, manufactures and sells inventory property to B, a member of the same consolidated group, in 1996. The sale between S and B is an intercompany transaction as defined under §1.1502–13(b)(1). The gain from the intercompany transaction is an intercompany item to S under §1.1502–13(b)(2). As of the beginning of the year of change in method of accounting (January 1, 1997), the inventory property is still held by B based on the particular inventory method of accounting used by B for federal income tax purposes (for example, the LIFO or FIFO inventory method). The property was

sold by S to B in 1996 for \$150; the cost of goods sold with respect to the property under the method in effect at the time the inventory was produced was \$100, resulting in an intercompany item of \$50 to S under §1.1502–13. As of January 1, 1997, S still has an intercompany item of \$50.

(ii) S is required to revalue the amount of its intercompany item to an amount equal to what the intercompany item would have been had the cost of goods sold for that inventory property been determined under S's new method. Assume that the cost of the inventory under this method would have been \$110, had the method applied to S's manufacture of the property in 1996. Thus, S is required to revalue the amount of its intercompany item to \$40 (that is, \$150 less \$110), necessitating a negative adjustment to the intercompany item of \$10. Moreover, S is required to increase its adjustment under section 481(a) by \$10 in order to prevent the omission of such amount by virtue of the decrease in the intercompany item.

(iii) *Availability of revaluation methods.* In revaluing the amount of any intercompany item resulting from the sale or exchange of inventory property in an intercompany transaction to an amount equal to the intercompany item that would have resulted had the cost of goods sold for that inventory property been determined under the taxpayer's new method, a taxpayer may use the other methods and procedures otherwise properly available to that particular taxpayer in revaluing inventory under section 263A and the regulations thereunder, including, if appropriate, the various simplified methods provided in section 263A and the regulations thereunder and the various procedures described in this paragraph (c).

(4) *Anti-abuse rule*—(i) *In general.* Section 263A(i)(1) provides that the Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the purposes of section 263A, including regulations to prevent the use of related parties, pass-thru entities, or intermediaries to avoid the application of section 263A and the regulations thereunder. One way in which the application of section 263A and the regulations thereunder would be otherwise avoided is through the use of entities described in the preceding sentence in such a manner as to effectively avoid the necessity to restate beginning inventory balances under the change in method of accounting required or permitted under section 263A and the regulations thereunder.

(ii) *Deemed avoidance of this section*—(A) *Scope.* For purposes of this paragraph (c), the avoidance of the application of section 263A and the regulations thereunder will be deemed to occur if a

taxpayer using the LIFO method of accounting for inventories, transfers inventory property to a related corporation in a transaction described in section 351, and such transfer occurs:

(1) On or before the beginning of the transferor's taxable year beginning in 1987; and

(2) After September 18, 1986.

(B) *General rule.* Any transaction described in paragraph (c)(4)(ii)(A) of this section will be treated in the following manner:

(1) Notwithstanding any provision to the contrary (for example, section 381), the transferee corporation is required to revalue the inventories acquired from the transferor under the provisions of this paragraph (c) relating to the change in method of accounting and the adjustment required by section 481(a), as if the inventories had never been transferred and were still in the hands of the transferor; and

(2) Absent an election as described in paragraph (c)(4)(iii) of this section, the transferee must account for the inventories acquired from the transferor by treating such inventories as if they were contained in the transferee's LIFO layer(s).

(iii) *Election to use transferor's LIFO layers.* If a transferee described in paragraph (c)(4)(ii) of this section so elects, the transferee may account for the inventories acquired from the transferor by allocating such inventories to LIFO layers corresponding to the layers to which such properties were properly allocated by the transferor, prior to their transfer. The transferee must account for such inventories for all subsequent periods with reference to such layers to which the LIFO costs were allocated. Any such election is to be made on a statement attached to the timely filed federal income tax return of the transferee for the first taxable year for which section 263A and the regulations thereunder applies to the transferee.

(iv) *Tax avoidance intent not required.* The provisions of paragraph (c)(4)(ii) of this section will apply to any transaction described therein, without regard to whether such transaction was consummated with an intention to avoid federal income taxes.

(v) *Related corporation.* For purposes of this paragraph (c)(4), a taxpayer is related to a corporation if—

(A) the relationship between such per-

sons is described in section 267(b)(1), or (B) such persons are engaged in trades or businesses under common control (within the meaning of paragraphs (a) and (b) of section 52).

(d) *Non-inventory property*—(1) *Need for adjustments.* A taxpayer that changes its method of accounting for costs subject to section 263A with respect to non-inventory property must revalue the non-inventory property on hand at the beginning of the year of change as set forth in paragraph (d)(2) of this section, and compute an adjustment under section 481(a). The adjustment under section 481(a) will equal the difference between the adjusted basis of the property as revalued using the taxpayer's new method and the adjusted basis of the property as originally valued using the taxpayer's former method.

(2) *Revaluing property.* A taxpayer must revalue its non-inventory property as of the beginning of the year of change in method of accounting. The facts and circumstances revaluation method of paragraph (c)(2)(iii) of this section must be used to revalue this property. In revaluing non-inventory property, however, the only additional section 263A costs that must be taken into account are those additional section 263A costs incurred after the later of December 31, 1986, or the date the taxpayer first be-

comes subject to section 263A, in taxable years ending after that date. See §1.263A-1(d)(3) for the definition of additional section 263A costs.

§ 1.263A-7T [Removed]

Par. 5. Section 1.263A-7T is removed.

§ 1.263A-15 [Amended]

Par. 6. Section 1.263A-15 is amended by removing "1.263A-7T (e) generally" from the last sentence in paragraph (a)(1) and replacing it with "1.263A-7".

Michael P. Dolan,
*Acting Commissioner of
Internal Revenue.*

Approved July 28, 1997.

Donald C. Lubick,
*Acting Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on August 4, 1997, 8:45 a.m., and published in the issue of the Federal Register for August 5, 1997, 62 F.R. 42051)

Section 472.—Last-in, First-out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department

stores. The July 1997 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, July 31, 1997.

Rev. Rul. 97-37

The following Department Store Inventory Price Indexes for July 1997 were issued by the Bureau of Labor Statistics on August 14, 1997. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, July 31, 1997.

The Department Store Inventory Price Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	July 1996	July 1997	Percent Change from July 1996 to July 1997 ¹
1. Piece Goods	539.2	539.8	0.1
2. Domestics and Draperies	635.6	656.1	3.2
3. Women's and Children's Shoes	643.9	641.6	-0.4
4. Men's Shoes	888.2	902.6	1.6
5. Infants' Wear	609.3	637.9	4.7
6. Women's Underwear	536.9	543.5	1.2
7. Women's Hosiery	289.3	297.8	2.9
8. Women's and Girls' Accessories	544.7	544.5	0.0
9. Women's Outerwear and Girls' Wear	380.6	395.0	3.8
10. Men's Clothing	610.3	621.6	1.9
11. Men's Furnishings	573.0	585.9	2.3
12. Boys' Clothing and Furnishings	475.9	495.9	4.2
13. Jewelry	1016.0	1003.9	-1.2
14. Notions	779.4	797.5	2.3
15. Toilet Articles and Drugs	880.9	905.7	2.8
16. Furniture and Bedding	671.6	662.8	-1.3
17. Floor Coverings	577.5	598.2	3.6

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100, unless otherwise noted)

Groups	July 1996	July 1997	Percent Change from July 1996 to July 1997 ¹
18. Housewares	811.9	807.2	-0.6
19. Major Appliances	245.8	243.1	-1.1
20. Radio and Television	79.2	75.9	-4.2
21. Recreation and Education ²	112.7	109.8	-2.6
22. Home Improvements ²	126.8	132.7	4.7
23. Auto Accessories ²	107.0	108.6	1.5
Groups 1 – 15: Soft Goods	582.4	594.9	2.1
Groups 16 – 20: Durable Goods	470.3	464.2	-1.3
Groups 21 – 23: Misc. Goods ²	113.5	112.5	-0.9
Store Total ³	544.2	549.8	1.0

¹Absence of a minus sign before percentage change in this column signifies price increase.

²Indexes on a January 1986=100 base.

³The store total index covers all departments, including some not listed separately, except for the following: candy, foods, liquor, tobacco, and contract departments.

DRAFTING INFORMATION

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

Section 6334.—Property Exempt From Levy

26 CFR 301.6334-1: Property exempt from levy.

T.D. 8725

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 301

Miscellaneous Sections Affected
by the Taxpayer Bill of Rights 2
and the Personal Responsibility
and Work Opportunity
Reconciliation Act of 1996

AGENCY: Internal Revenue Service
(IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains
final regulations relating to joint returns,

property exempt from levy, interest, penalties, offers in compromise, and the awarding of costs and certain fees. The regulations reflect changes to the law made by the Taxpayer Bill of Rights 2 and a conforming amendment made by the Personal Responsibility and Work Opportunity Reconciliation Act of 1996. The regulations affect taxpayers with respect to filing of returns, interest, penalties, court costs, and payment, deposit, and collection of taxes.

DATES: These regulations are effective July 22, 1997.

For dates of applicability of these regulations, see §§301.6334-1(e) and (f), 301.6601-1(f)(3) and (4), 301.6651-1(a)(3) and (g)(2), 301.6656-3(c), 301.7122-1(e)(2), 301.7430-2(c)(3)-(i)(B), 301.7430-4(b)(3)(ii), 301.7430-5(a) and (c)(3), and 301.7430-6.

FOR FURTHER INFORMATION CONTACT: Beverly A. Baughman, (202) 622-4940 regarding joint returns and penalties; Robert A. Miller, (202) 622-3640 regarding levy; Donna J. Welch, (202) 622-4910 regarding interest; Thomas D. Moffitt, (202) 622-7900 regarding court costs; and Kevin B. Connelly, (202) 622-3640 regarding compromises (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1356. Responses to this collection of information are required to obtain an award of reasonable administrative costs.

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 estimated annual burden per respondent varies from 10 minutes to 30 minutes, depending on individual circumstances, with an estimated average of 15 minutes.

Comments concerning the accuracy of this burden estimate and suggestions for reducing this burden should be sent to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, PC:FP, Washington, DC 20224, and to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503.

Books or records relating to a collec-

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

Background

This document contains amendments to the Income Tax Regulations and the Regulations on Procedure and Administration (26 CFR parts 1 and 301, respectively) relating to joint returns under section 6013, levy under section 6334, interest under section 6601, the failure to file penalty under section 6651, the failure to deposit penalty under section 6656, compromise under section 7122, and awards of costs and certain fees under section 7430. These sections were amended by the Taxpayer Bill of Rights 2 (TBOR2) (Public Law 104-168, 110 Stat. 1452 (1996)) and section 110(l)(6) of the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (Public Law 104-193, 110 Stat. 2105, 2173 (1996)). The changes made by TBOR2 and the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 are reflected in the final regulations.

A notice of proposed rulemaking was published in the **Federal Register** for January 2, 1997 (62 FR 77). One written comment was received in response to the notice of proposed rulemaking. No public hearing was requested or held. The proposed regulations under sections 6013, 6334, 6601, 6651, 6656, 7122, and 7430 are adopted by this Treasury decision with minor revisions, which are discussed below.

Explanation of Revisions and Summary of Comments

The IRS received one comment regarding the proposed regulations. The commentator remarked that §301.6601-1(f)(3) of the proposed regulations is unclear because, as drafted, the regulation implies that interest on all additions to tax, including those covered by section 6601(e)-(2)(B), runs from the date of the notice and demand. Therefore, the final regulations clarify that interest on any addition to tax, except additions to tax described in section 6601(e)(2)(B), begins to run from the date of the notice and demand.

The commentator also requested clari-

fication for purposes of computing the \$100,000 threshold in §§301.6601-1(f)(3) and (4) and 301.6651-1(a)(3). Sections 303(a) and (b) of TBOR2 extend the interest-free period to 21 calendar days or 10 business days if the amount for which the notice and demand is made equals or exceeds \$100,000. The commentator suggested that the \$100,000 threshold should include tax, interest, and penalties. The language in the statute supports this interpretation. Under section 303(b)(1) of TBOR2, the 10 day period specifically applies to a notice and demand for interest and penalties. Therefore, the final regulations clarify that 10 business days is the applicable interest-free period if the total amount assessed, including tax, penalties, and interest, and shown on the notice and demand equals or exceeds \$100,000.

In addition, §301.6651-1(a)(3), regarding the failure to pay penalty, has been clarified by cross-referencing the definitions of calendar day and business day in §301.6601-1(f)(5).

Effective Dates

These regulations are applicable on July 31, 1996, except that §301.7122-1(e) is applicable on July 30, 1996, and §301.6334-1(a)(2), (a)(3), (a)(11)(i), and (e), §301.6601-1(f)(3), (f)(4), and (f)(5), §301.6651-1(a)(3), and §301.7430-4(b)(3)(ii) are applicable on January 1, 1997.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Moreover, it is hereby certified that the regulations in this document will not have a significant economic impact on a substantial number of small entities. This certification is based on a determination that in the past only an average of 38 taxpayers per year, the majority of whom were individuals, have filed a request to recover administrative costs. 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 Inter-

nal Revenue 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 the impact of the proposed regulations on small business.

Drafting Information

The principal authors of these regulations are Beverly A. Baughman and Donna J. Welch, Office of Assistant Chief Counsel (Income Tax and Accounting), Robert A. Miller and Kevin B. Connelly, Office of Assistant Chief Counsel (General Litigation), and Thomas D. Moffitt, Office of Assistant Chief Counsel (Field Service). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 301 are amended as follows:

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.6013-2(b)(1) is amended by removing the language “Unless” and adding “Beginning on or before July 30, 1996, unless” in its place.

PART 301—PROCEDURE AND ADMINISTRATION

Par. 3. The authority citation for part 301 continues to read in part as follows:

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

Par. 4. Section 301.6334-1 is amended by:

1. Revising paragraph (a)(2).
2. Removing the language “\$1,100 (\$1,050 for levies issued prior to January 1, 1990)” from paragraph (a)(3) and adding “\$1,250” in its place.
3. Removing the language “(relating to aid to families with dependent children)” from paragraph (a)(11)(i).
4. Revising paragraph (e).
5. Adding paragraph (f).

The additions and revisions read as follows:

§301.6334-1 *Property exempt from levy.*

(a) * * *

(2) *Fuel, provisions, furniture, and personal effects.* So much of the fuel, provisions, furniture, and personal effects in the taxpayer's household, and of the arms for personal use, livestock, and poultry of the taxpayer, that does not exceed \$2,500 in value.

* * * * *

(e) *Inflation adjustment.* For any calendar year beginning after December 31, 1997, each dollar amount referred to in paragraphs (a)(2) and (3) of this section will be increased by an amount equal to the dollar amount multiplied by the cost-of-living adjustment determined under section 1(f)(3) for the calendar year (substituting "calendar year 1996" for "calendar year 1992" in section 1(f)(3)(B)). If any dollar amount as adjusted is not a multiple of \$10, the dollar amount will be rounded to the nearest multiple of \$10 (rounding up if the amount is a multiple of \$5).

(f) *Effective date.* Generally, these provisions are applicable with respect to levies made on or after July 1, 1989. However, any reasonable attempt by a taxpayer to comply with the statutory amendments addressed by the regulations in this section prior to February 21, 1995, will be considered as meeting the requirements of the regulations in this section. In addition, paragraphs (a)(2), (3), (11)(i) and (e) of this section are applicable with respect to levies issued after December 31, 1996.

Par. 5. Section 301.6601-1 is amended by:

- 1. Revising paragraphs (f)(3) and (f)(4).
- 2. Redesignating paragraph (f)(5) as paragraph (f)(6) and adding new paragraph (f)(5).

The additions and revisions read as follows:

§301.6601-1 *Interest on underpayments.*

* * * * *

(f) * * *

(3) Interest will not be imposed on any assessable penalty, addition to the tax (other than an addition to tax described in section 6601(e)(2)(B)), or additional amount if the amount is paid within 21 calendar days (10 business days if the amount assessed and shown on the notice and demand equals or exceeds \$100,000) from the date of the notice and demand. If interest is imposed, it will be imposed

only for the period from the date of the notice and demand to the date on which payment is received. This paragraph (f)(3) is applicable with respect to any notice and demand made after December 31, 1996.

(4) If notice and demand is made after December 31, 1996, for any amount and the amount is paid within 21 calendar days (10 business days if the amount assessed and shown on the notice and demand equals or exceeds \$100,000) from the date of the notice and demand, interest will not be imposed for the period after the date of the notice and demand.

(5) For purposes of paragraphs (f)(3) and (4) of this section—

(i) The term *business day* means any day other than a Saturday, Sunday, legal holiday in the District of Columbia, or a statewide legal holiday in the state where the taxpayer resides or where the taxpayer's principal place of business is located. With respect to the tenth business day (after taking into account the first sentence of this paragraph (f)(5)(i)), see section 7503 relating to time for performance of acts where the last day falls on a statewide legal holiday in the state where the act is required to be performed.

(ii) The term *calendar day* means any day. With respect to the twenty-first calendar day, see section 7503 relating to time for performance of acts where the last day falls on a Saturday, Sunday, or legal holiday.

* * * * *

Par. 6. Section 301.6651-1 is amended by:

- 1. Revising paragraph (a)(3).
- 2. Adding paragraph (g).

The addition and revision read as follows:

§301.6651-1 *Failure to file tax return or to pay tax.*

(a) * * *

(3) *Failure to pay tax not shown on return.* In the case of failure to pay any amount of any tax required to be shown on a return specified in paragraph (a)(1) of this section that is not so shown (including an assessment made pursuant to section 6213(b)) within 21 calendar days from the date of the notice and demand (10 business days if the amount assessed and shown on the notice and demand equals or exceeds \$100,000) with respect

to any notice and demand made after December 31, 1996, there will be added to the amount stated in the notice and demand the amount specified below unless the failure to pay the tax within the prescribed time is shown to the satisfaction of the district director or the director of the service center to be due to reasonable cause and not to willful neglect. The amount added to the tax is 0.5 percent of the amount stated in the notice and demand if the failure is for not more than 1 month, with an additional 0.5 percent for each additional month or fraction thereof during which the failure continues, but not to exceed 25 percent in the aggregate. For purposes of this paragraph (a)(3), see §301.6601-1(f)(5) for the definition of *calendar day* and *business day*.

* * * * *

(g) *Treatment of returns prepared by the Secretary—*(1) *In general.* A return prepared by the Secretary under section 6020(b) will be disregarded for purposes of determining the amount of the addition to tax for failure to file any return pursuant to paragraph (a)(1) of this section. However, the return prepared by the Secretary will be treated as a return filed by the taxpayer for purposes of determining the amount of the addition to tax for failure to pay the tax shown on any return and for failure to pay the tax required to be shown on a return that is not so shown pursuant to paragraphs (a)(2) and (3) of this section, respectively.

(2) *Effective date.* This paragraph (g) applies to returns the due date for which (determined without regard to extensions) is after July 30, 1996.

Par. 7. Section 301.6656-3 is added to read as follows:

§301.6656-3 *Abatement of penalty.*

(a) *Exception for first time depositors of employment taxes—*(1) *Waiver.* The Secretary will generally waive the penalty imposed by section 6656(a) on a person's failure to deposit any employment tax under subtitle C of the Internal Revenue Code if—

- (i) The failure is inadvertent;
- (ii) The person meets the requirements referred to in section 7430(c)(4)(A)(ii) (relating to the net worth requirements applicable for awards of attorney's fees);
- (iii) The failure occurs during the first

quarter that the person is required to deposit any employment tax; and

(iv) The return of the tax is filed on or before the due date.

(2) *Inadvertent failure.* For purposes of paragraph (a)(1)(i) of this section, the Secretary will determine if a failure to deposit is inadvertent based on all the facts and circumstances.

(b) *Deposit sent to Secretary.* The Secretary may abate the penalty imposed by section 6656(a) if the first time a depositor is required to make a deposit, the amount required to be deposited is inadvertently sent to the Secretary instead of to the appropriate government depository.

(c) *Effective date.* This section applies to deposits required to be made after July 30, 1996.

Par. 8. n §301.7122-1, paragraph (e) is revised to read as follows:

§301.7122-1 *Compromises.*

* * * * *

(e) *Record*—(1) *In general.* If an offer in compromise is accepted, there will be placed on file the opinion of the Chief Counsel of the IRS with respect to the compromise, with the reasons for the opinion, and including a statement of—

- (i) The amount of tax assessed;
- (ii) The amount of interest, additional amount, addition to the tax, or assessable penalty, imposed by law on the person against whom the tax is assessed; and
- (iii) The amount actually paid in accordance with the terms of the compromise.

(2) *Exception.* For compromises accepted on or after July 30, 1996, no opinion will be required with respect to the compromise of any civil case in which the unpaid amount of tax assessed (including any interest, additional amount, addition to the tax, or assessable penalty) is less than \$50,000. However, the compromise will be subject to continuing quality review by the Secretary.

* * * * *

Par 9. Section 301.7430-0 is amended by adding entries for §§301.7430-1(b)(4) and 301.7430-5(c)(3) to read as follows:

§301.7430-0 *Table of contents.*

* * * * *

§301.7430-1 *Exhaustion of administrative remedies.*

* * * * *

(b) * * *

(4) Failure to agree to extension of time for assessments.”.

* * * * *

§301.7430-5 *Prevailing party.*

* * * * *

(c) * * *

(3) Presumption.

* * * * *

Par. 10. Section 301.7430-1 is amended by adding paragraph (b)(4) to read as follows:

§301.7430-1 *Exhaustion of administrative remedies.*

* * * * *

(b) * * *

(4) Failure to agree to extension of time for assessments. Any failure by the prevailing party to agree to an extension of the time for the assessment of any tax will not be taken into account for purposes of determining whether the prevailing party has exhausted the administrative remedies available to the party within the Internal Revenue Service.

* * * * *

Par. 11. Section 301.7430-2 is amended by:

- 1. Removing the language “7430(c)-(4)(B)(ii)” from the third sentence of paragraph (b)(2) and adding “7430(c)(4)-(C)(ii)” in its place.
- 2. The introductory text of paragraph (c)(3) is amended by removing the colon and adding a dash in its place.
- 3. Revising paragraph (c)(3)(i)(B).
- 4. Removing the language “If more than \$75” from paragraph (c)(3)(ii)(C) and adding “In the case of administrative proceedings commenced after July 30, 1996, if more than \$110” in its place.

The revision reads as follows:

§301.7430-2 *Requirements and procedures for recovery of reasonable administrative costs.*

* * * * *

(c) * * *

(3) * * *

(i) * * *

(B) A clear and concise statement of the reasons why the taxpayer alleges that the position of the Internal Revenue Service in the administrative proceeding was not substantially justified. For administrative proceedings commenced after July 30, 1996, if the taxpayer alleges that the Internal Revenue Service did not follow any applicable published guidance, the statement must identify all applicable published guidance that the taxpayer alleges that the Internal Revenue Service did not follow. For purposes of this paragraph (c)(3)(i)(B), the term applicable published guidance means final or temporary regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if issued to the taxpayer, private letter rulings, technical advice memoranda, and determination letters. Also, for purposes of this paragraph (c)(3)(i)(B), the term administrative proceeding includes only those administrative proceedings or portions of administrative proceedings occurring on or after the administrative proceeding date as defined in §301.7430-3(c);

* * * * *

Par. 12. Section 301.7430-4 is amended by:

- 1. Removing the language “\$75” from paragraph (b)(3)(i) and adding “, in the case of proceedings commenced after July 30, 1996, \$110” in its place.
- 2. Revising paragraph (b)(3)(ii).
- 3. Removing the language “\$75” from the first, second, and third sentences of paragraph (b)(3)(iii)(B) and adding “\$110” in its place.
- 4. Removing the language “\$75” from the first sentence of paragraph (b)(3)-(iii)(C) and adding “\$110” in its place.
- 5. Removing the language “\$75” from the third sentence of the example in paragraph (b)(3)(iii)(D) and adding “\$110” in its place.
- 6. Removing the language “\$75” from the second and third sentences of paragraph (c)(2)(ii) and adding “\$110” in its place.

The revision reads as follows:

§301.7430-4 *Reasonable administrative costs.*

* * * * *

- (b) * * *
- (3) * * *

(ii) Cost of living adjustment. The Internal Revenue Service will make a cost of living adjustment to the \$110 per hour limitation for fees incurred in any calendar year beginning after December 31, 1996. The cost of living adjustment will be an amount equal to \$110 multiplied by the cost of living adjustment determined under section 1(f)(3) for the calendar year (substituting "calendar year 1995" for "calendar year 1992" in section 1(f)(3)(B)). If the dollar limitation as adjusted by this cost of living increase is not a multiple of \$10, the dollar amount will be rounded to the nearest multiple of \$10 (rounding up if the amount is a multiple of \$5).

* * * * *

Par. 13. Section 301.7430-5 is amended by:

1. Revising paragraph (a).
2. Adding paragraph (c)(3).

The addition and revision read as follows:

§301.7430-5 Prevailing party.

(a) *In general.* For purposes of an award of reasonable administrative costs under section 7430 in the case of administrative proceedings commenced after July 30, 1996, a taxpayer is a prevailing party only if—

- (1) The position of the Internal Revenue Service was not substantially justified;

(2) The taxpayer substantially prevails as to the amount in controversy or with respect to the most significant issue or set of issues presented; and

(3) The taxpayer satisfies the net worth and size limitations referenced in paragraph (f) of this section.

* * * * *

(c) * * *

(3) *Presumption.* If the Internal Revenue Service did not follow any applicable published guidance in an administrative proceeding commenced after July 30, 1996, the position of the IRS, on those issues to which the guidance applies and for all periods during which the guidance was not followed, will be presumed not to be substantially justified. This presumption may be rebutted. For purposes of this paragraph (c)(3), the term applicable published guidance means final or temporary regulations, revenue rulings, revenue procedures, information releases, notices, announcements, and, if issued to the taxpayer, private letter rulings, technical advice memoranda, and determination letters (see §601.601(d)(2) of this chapter). Also, for purposes of this paragraph (c)(3), the term administrative proceeding includes only those administrative proceedings or portions of administrative proceedings occurring on or after the administrative proceeding date as defined in §301.7430-3(c).

* * * * *

Par. 14. Section 301.7430-6 is revised to read as follows:

§301.7430-6 Effective dates.

Sections 301.7430-2 through 301.7430-6, other than §§301.7430-2(b)(2), (c)(3)(i)(B), (c)(3)(ii)(C), and (c)(5); §§301.7430-4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and §§301.7430-5(a) and (c)(3), apply to claims for reasonable administrative costs filed with the Internal Revenue Service after December 23, 1992, with respect to costs incurred in administrative proceedings commenced after November 10, 1988. Section 301.7430-2(c)(5) is applicable March 23, 1993. Section 301.7430-2(b)(2), (c)(3)(i)(B), and (c)(3)(ii)(C); 301.7430-4(b)(3)(i), (b)(3)(ii), (b)(3)(iii)(B), (b)(3)(iii)(C), (b)(3)(iii)(D), and (c)(2)(ii); and 301.7430-5(a) and (c)(3) are applicable for administrative proceedings commenced after July 30, 1996.

Margaret Milner Richardson,
Commissioner of Internal Revenue.

Approved June 27, 1997.

Donald C. Lubick,
*Acting Assistant Secretary of
the Treasury.*

(Filed by the Office of the Federal Register on July 21, 1997, 8:45 a.m., and published in the issue of the Federal Register for July 22, 1997, 62 F.R. 39115)

Part III. Administrative, Procedural, and Miscellaneous

Designated Private Delivery Services

Notice 97-50

This notice provides that the list of private delivery services (“PDSs”) designated under Notice 97-26, 1997-17 I.R.B. 6, (“designated PDSs”) for purposes of the “timely mailing as timely filing/paying” rule of § 7502 of the Internal Revenue Code will remain in effect until further notice. This notice also modifies Rev. Proc. 97-19, 1997-10 I.R.B. 55, and Notice 97-26 by changing the periods during which PDSs can apply for designation and the dates that the Service will announce the new list of designated PDSs.

Section 7502(f) authorizes the Secretary to designate certain PDSs for the “timely mailing as timely filing/paying” rule of § 7502. Rev. Proc. 97-19 provides the criteria currently applicable for designation of a PDS. Rev. Proc. 97-19 (section 7.01(2)) provides for semiannual application periods ending on June 30th and December 31st. Rev. Proc. 97-19 (section 8.02) and Notice 97-26 provide that the Service will issue a revised list of designated PDSs on or before September 1st

and March 1st of each year for which Rev. Proc. 97-19 is in effect.

Notice 97-26 designates the following PDSs with respect to the following specific services they provide:

1. Airborne Express (Airborne): Overnight Air Express Service, Next Afternoon Service, and Second Day Service

2. DHL Worldwide Express (DHL): DHL “Same Day” Service and DHL USA Overnight

3. Federal Express (FedEx): FedEx Priority Overnight, FedEx Standard Overnight, and FedEx 2Day

4. United Parcel Service (UPS): UPS Next Day Air, UPS Next Day Air Saver, UPS 2nd Day Air, and UPS 2nd Day Air A.M.

Airborne, DHL, FedEx, and UPS are not designated with respect to any type of delivery service not identified above. Notice 97-26 also provides special rules used to determine the date that will be treated as the postmark date for purposes of § 7502.

The Service received no applications for designation during the most recent application period, which ended June 30, 1997. Accordingly, until further notice, the list of designated PDSs in Notice 97-26 will remain in effect.

Section 7.01(2) of Rev. Proc. 97-19 is modified to provide that each year there will be only one application period, which will end on June 30th. Also, section 8.02 of Rev. Proc. 97-19 and Notice 97-26 are modified to provide that the Service will issue a notice providing a new list of designated PDSs on or before September 1st of each year for which Rev. Proc. 97-19 is in effect.

EFFECT ON OTHER DOCUMENTS

Notice 97-26 and Rev. Proc. 97-19 are modified.

EFFECTIVE DATE

This notice is effective on September 1, 1997.

FOR FURTHER INFORMATION

The principal author of this notice is Robert J. Basso of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Mr. Basso at (202) 622-4940 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking and Notice of Public Hearing

Qualified Nonrecourse Financing Under Section 465(b)(6)

REG-105160-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations under section 465(b)(6) regarding qualified nonrecourse financing. The proposed regulations address whether the personal liability of an entity prevents financing from being treated as qualified nonrecourse financing and whether qualified nonrecourse financing may be secured by property that is incidental to the activity of holding real property. The proposed regulations would affect partnerships and their partners. This document also gives notice of a public hearing scheduled for December 10, 1997.

DATES: Written comments and requests to speak (with outlines of oral comments) at the public hearing scheduled for December 10, 1997, must be received by November 19, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-105160-97), 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 (REG-105160-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html. 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, Jeffrey A. Erickson, (202) 622-3070; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Introduction

This document contains proposed regulations under section 465(b)(6) of the Internal Revenue Code (Code). Section 465, which applies to individuals and certain corporations, limits a taxpayer's loss deduction for an activity to the amount of the taxpayer's amount at risk in the activity at the close of the taxable year. A taxpayer's amount at risk generally includes the amount of any cash and the adjusted tax basis of any property contributed by the taxpayer to the activity plus any amounts borrowed for use in the activity to the extent the taxpayer is personally liable for repayment.

For the activity of holding real property, a taxpayer may also include as an amount at risk the taxpayer's share of any "qualified nonrecourse financing" that is secured by real property used in the activity of holding real property, even though the taxpayer is not personally liable for repayment of the financing. Section 465(b)(6) defines qualified nonrecourse financing as any financing that (i) is borrowed by the taxpayer for the activity of holding real property; (ii) is borrowed by the taxpayer from a qualified person or represents a loan from any federal, state, or local government or instrumentality thereof, or is guaranteed by any federal, state, or local government; (iii) except to the extent provided in regulations, no person is personally liable for repayment; and (iv) is not convertible debt.

Explanation of Provisions

I. Secured by Real Property

Section 465(b)(6)(A) provides that qualified nonrecourse financing must be secured by real property used in the activity of holding real property. The legislative history of section 465(b)(6) suggests that qualified nonrecourse financing can be secured only by real property. H.R. Rep. No.

426, 99th Cong., 1st Sess. 293 (1985), 1986-3 (Vol. 2) C.B. 293; S. Rep. No. 313, 99th Cong., 2d Sess. 748 (1986), 1986-3 (Vol. 3) C.B. 748. Section 465(b)(6)(E), however, provides that the activity of holding real property includes the holding of personal property that is incidental to making real property available as living accommodations. Section 465(b)(6) does not specifically provide that such incidental property may be used to secure qualified nonrecourse financing. The proposed regulations provide that financing can qualify as qualified nonrecourse financing if, in addition to the real property used in the activity of holding real property, the financing is secured by both real property and other property that is incidental to the activity of holding real property.

II. Personal Liability

Section 465(b)(6)(B)(iii) provides that, except to the extent provided in regulations, no person may be personally liable for repayment of qualified nonrecourse financing. The legislative history of section 465 states that regulations may provide rules under which the guaranty, indemnity, or personal liability of a person other than the taxpayer does not cause the financing to be treated as other than qualified nonrecourse financing. H.R. Rep. No. 426, 99th Cong., 1st Sess. 294 (1985), 1986-3 (Vol. 2) C.B. 294; S. Rep. No. 313, 99th Cong., 2d Sess. 749 (1986), 1986-3 (Vol. 3) C.B. 749.

A partnership is treated as a person under the Code. Thus, any financing for which a partnership is personally liable is not qualified nonrecourse financing under section 465(b)(6)(B)(iii), even if no partner is personally liable for the financing. This result is inappropriate if the only activity of the partnership is the real property activity; the personal liability of the partnership in that situation is not meaningful and the financing is the equivalent of nonrecourse financing. Situations in which a partnership is liable for repayment, but no partner is personally liable, may be unusual for general and limited partnerships; however, such situations may become increasingly common with the use of limited liability companies (LLCs) in which the LLC is personally liable for its debts and the members of the

LLC are not liable. In response, the proposed regulations provide that the personal liability of a partnership (including an LLC that is treated as a partnership) is disregarded in determining whether a financing is qualified nonrecourse financing if the entity's only assets are real property used in the activity of holding real property or both real property and other property that is incidental to the activity of holding real property, and no other person is liable for the financing.

In addition, section 465(b)(6) does not specifically provide that financing may qualify as qualified nonrecourse financing if a person is personally liable for a portion of the financing. Treating the portion of the financing for which no person is personally liable as qualified nonrecourse financing would not be inconsistent with the underlying policy of section 465. Therefore, the proposed regulations provide that the portion for which no person is personally liable can qualify as qualified nonrecourse financing.

Proposed Effective Date

These regulations are proposed to be effective for financing incurred on or after the date final regulations are published in the **Federal Register**.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis 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 its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written com-

ments (preferably a signed original and eight (8) copies) that are submitted timely to the IRS. All comments will be available for public inspection and copying.

A public hearing has been scheduled for December 10, 1997, 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 Internal Revenue 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 timely written comments (preferably a signed original and eight (8) copies) and an outline of the topics to be discussed and the time to be devoted to each topic by November 19, 1997.

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 Jeffrey A. Erickson, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

§1.465-27(b)(3) also issued under 26 U.S.C. 465(b)(6)(B)(iii). * * *

Par. 2. Section 1.465-27 is added to read as follows:

§1.465-27 Qualified nonrecourse financing

(a) *In general.* Notwithstanding any provision of section 465(b) or the regulations under section 465, in the case of an

activity of holding real property, a taxpayer is considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing that is secured by real property used in such activity.

(b) *Qualified nonrecourse financing—*
(1) *In general.* For section 465(b)(6) and this section, the term qualified nonrecourse financing means any financing—

(i) Which is borrowed by the taxpayer with respect to the activity of holding real property;

(ii) Which is borrowed by the taxpayer from a qualified person or represents a loan from any federal, state, or local government or instrumentality thereof, or is guaranteed by any federal, state, or local government;

(iii) Except as otherwise provided in paragraph (b)(3)(ii) of this section, for which no person is personally liable for repayment; and

(iv) Which is not convertible debt.

(2) *Secured by incidental property.* A taxpayer will be considered at risk with respect to the taxpayer's share of any qualified nonrecourse financing secured by real property used in the activity of holding real property, where such financing is also secured by property that is incidental to the activity of holding such real property.

(3) *Personal liability—*(i) *Partial liability.* If a person is personally liable for repayment of a portion of a financing, the portion of the financing for which no person is personally liable can qualify as qualified nonrecourse financing.

(ii) *Partnership liability.* The personal liability of an entity classified as a partnership for repayment of a financing shall be disregarded in determining whether the financing is qualified nonrecourse financing, if the only assets of the partnership are either real property used in the activity of holding real property or both such real property and other property that is incidental to the activity of holding such real property, and no other person is liable for repayment of the financing.

(4) *Examples.* The following examples illustrate the rules of paragraph (b) of this section:

Example 1. Personal liability of partnership; Incidental property. X is a limited liability company that is classified as a partnership for federal tax purposes. X is engaged only in the activity of holding real property. In addition to real property used in the activity of holding real property, X owns office equipment, a truck, and maintenance equipment that it uses to support the activity of holding real prop-

erty. X borrows \$500 to use in the activity. X is personally liable on the financing, but no member of X and no other person is liable for repayment of the financing. Under paragraph (b)(3)(ii) of this section, the personal liability of X for repayment of the financing is disregarded when determining whether the financing is qualified nonrecourse financing. Under paragraph (b)(2) of this section, the personal property is treated as incidental personal property used in the activity of holding real property. Therefore, assuming the financing satisfies the other requirements for qualified nonrecourse financing, the financing will be treated as qualified nonrecourse financing.

Example 2. Bifurcation of financing. The facts are the same as in Example 1, except that A, a member of X, is personally liable for repayment of \$100 of the financing. Under paragraph (b)(3)(i) of this section, the portion of the financing for which A is not personally liable for repayment (\$400) can qualify as qualified nonrecourse financing.

(c) *Effective date.* This section is effective for financing incurred on or after the date the final regulations are published in the **Federal Register**.

Michael P. Dolan,
*Acting Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on August 12, 1997, 8:45 a.m., and published in the issue of the Federal Register for August 13, 1997, 62 F.R. 43295)

Notice of Proposed Rulemaking
Remedial Amendment Period
REG-106043-97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: T.D. 8727, 1997-34 I.R.B. 5, the IRS is issuing temporary regulations relating to the remedial amendment period during which a sponsor of a qualified retirement plan or an employer that maintains a qualified retirement plan can make retroactive amendments to the plan to eliminate certain qualification defects for the entire period. The text of those temporary regulations also serves as the text of these proposed regulations. These proposed regulations will affect sponsors of qualified retirement plans, and employers that maintain qualified retirement plans.

DATES: Written comments and requests for a public hearing must be received by

October 30, 1997.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-106043-97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-106043-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS internet site at http://www.irs.ustreas.gov/prod/tax_regsg/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, Linda S. F. Marshall, (202) 622-6030; concerning submissions, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Final and temporary regulations in T.D. 8727 amend the Income Tax Regulations (26 CFR part 1) relating to section 401(b). The regulations provide guidance to clarify the scope of the Commissioner's authority to provide relief from plan disqualification under section 401(b) and the regulations.

The text of T.D. 8727 the temporary regulations also serves as the text of these proposed regulations. The preamble to the final and temporary regulations explains the temporary regulations.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because the regulation does 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, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its

impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Linda S. F. Marshall, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations). However, other personnel from the IRS and Treasury Department participated in their development.

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

Par. 2. Section 1.401(b)-1 is amended by:

1. Revising paragraphs (b)(3), (c) and (d)(1)(iv).
2. Adding paragraph (d)(1)(v).

The addition and revisions read as follows:

§1.401(b)-1 Certain retroactive changes in plan.

[The text of proposed paragraphs (b)(3), (c), (d)(1)(iv) and (v) is the same as the text of §1.401(b)-1T(b)(3), (c), (d)(1)(iv) and (v) published in T.D. 8727.]

Michael P. Dolan,
*Acting Commissioner of
Internal Revenue.*

(Filed by the Office of the Federal Register on July 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for August 1, 1997, 62 F.R. 41322)

Changes to Excise Taxes

Announcement 97-91

Purpose

To announce additional excise tax changes made by the Taxpayer Relief Act of 1997 (P.L. 105-34). These changes affect taxes on:

- Fuels
- Communications
- Air transportation
- Heavy highway vehicles
- Luxury automobiles
- Arrow components

Note: *Announcement 97-78, 1997-34 I.R.B. 11, released on August 14, 1997, covered certain changes made by the Act that took effect during August of 1997. Those changes affect the tax on the use of international air travel facilities, the date for deposits of air transportation taxes, and the tax on vaccines.*

Fuel tax rates

The changes listed below apply after September 30, 1997.

- The table below shows the new rates for fuels (other than those included under IRS No. 79) due to the reinstatement of the Leaking Underground Storage Tank Trust Fund tax (generally \$.001 per gallon).
- The rate on liquefied petroleum gas has decreased; this fuel will be identified separately as **IRS No. 61**.
- Other special fuels and alcohol fuels (other than gasohol) will be identified under **IRS No. 79**. (See the Instructions for Form 720 for this list.)

IRS No.	Type of fuel	Tax rate per gallon
62	Gasoline	\$.184
59	Gasohol containing at least 10% alcohol	\$.130
75	Gasohol containing at least 7.7% alcohol	\$.14242
76	Gasohol containing at least 5.7% alcohol	\$.15322
58	Gasoline removed or entered for gasohol production, at least 10% alcohol	\$.14444
73	Gasoline removed or entered for gasohol production, at least 7.7% alcohol	\$.1543
74	Gasoline removed or entered for gasohol production, at least 5.7% alcohol	\$.16248
60	Diesel fuel	\$.244
71	Dyed diesel fuel used in trains	\$.0565
78	Dyed diesel fuel used in certain buses	\$.074
61	Liquefied petroleum gas (LPG)	\$.136
14	Aviation gasoline	\$.194
69	Aviation fuel (other than gasoline)	\$.219
77	Aviation fuel (commercial)	\$.044
64	Inland waterways fuel use	\$.244

Communications tax

In the case of communications services acquired by means of a prepaid telephone card, the 3% excise tax is imposed on the face amount of the card when the card is transferred by a telecommunications carrier to any person who is not a carrier. The provision will be effective after October 31, 1997.

Transportation of persons by air

For amounts paid after September 30, 1997, for transportation beginning after September 30, 1997, the following changes apply:

- The tax is 9% (7.5% for segments to or from rural airports), plus \$1.00 for each domestic segment (excluding segments to or from rural airports).
- Amounts paid to an air carrier for the right to provide mileage awards or other reductions in the cost of any transportation of persons are treated as amounts paid for taxable transportation.

Retail tax on heavy highway vehicles

The following changes apply after December 31, 1997, except as noted:

- The repair or modification of a vehicle will not be treated as manufacture for excise tax purposes unless

the repair or modification costs exceed 75% of the retail price of a comparable new vehicle. This rule does not apply if the vehicle as repaired or modified would, if new, be taxable, and the vehicle when new was not taxable.

- The registration requirement applicable to certain sales of trucks, tractors, and trailers will be replaced with a certification requirement.
- Parts or accessories added to a heavy truck within six months of the initial purchase will be taxable only if the aggregate price of the additions is more than \$1,000. (This change is effective for vehicles sold after August 5, 1997.)
- A credit against the retail tax on heavy highway vehicles will be allowed for excise tax imposed on tires sold on or in connection with the vehicle. This replaces the exclusion from the amount subject to the heavy vehicle tax allowed for tire value.

Luxury tax

Effective after August 5, 1997, the luxury tax threshold is raised for electric and clean-fuel motor vehicles.

- The electric vehicle threshold is 150 percent of the luxury tax threshold.
- The clean-fuel motor vehicle threshold is the luxury tax threshold plus an amount equal to the increase in the price of the vehicle attributable to the retrofit parts and components installed that permit the vehicle to be clean burning.

Also effective for vehicles sold after August 5, 1997, parts or accessories added to a luxury automobile within six months of the initial purchase are only taxable if the aggregate price of the additions is more than \$1,000.

Arrow components

Effective after September 30, 1997, a 12.4% tax will be imposed on the price for which the manufacturer sells any point,nock, vane, or shaft of the type used in the manufacture of any arrow. This replaces the tax on arrows. The tax will be reported under new **IRS No. 102**.

Foundations Status of Certain Organizations

Announcement 97-92

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Across the Bridge Eastside Children's Museum, Bellevue, WA
 African Christian Fellowship of California Inc., Fullerton, CA
 Ark Ministries, Inc., Lewisville, TX
 Burlington-Edison School District Foundation, Burlington, WA

Celestial Flight Nonprofit Housing Corporation, Detroit, MI
 Cerebral Palsy SOS, Inc., New York, NY
 Challenges, Inc., Atlanta, GA
 Chippechaug Christian Camp Inc., Meriden, CT
 Church of Gospel Ministry, Lenoxdale, MA
 Classic Foundation, Inc., Fitchburg, MA
 Families A La Carte, Vallejo, CA
 The Family School, Bronx, NY
 Florida Home Incorporated, Richmond, CA
 Foundation for Genetics Research, Houston, TX
 The Foundation for Living, Tacoma, WA
 Foundation for the Special Commission on the Administration of Justice in Illinois, Chicago, IL
 Friends of Evergreen, Portland, ME
 Haverhill Junior Football League, Haverhill, MA
 Home Care for Christian Scientists, Inc., Boston, MA
 Illinois Town Hall Meetings, Rolling Meadows, IL
 Imperial Valley Affordable Housing, Brawley, CA
 Interculture, Inc., New York, NY
 International Friends of Migdal Ohr Institutions, New York, NY
 In the Best Interests of the Children, Inc., Boston, MA

James Phillip Family Foundation of Cleveland, Willoughby Hills, OH
 Japanese-American International Art Corporation, New York, NY
 Japanese Community Association, Inc., Scarsdale, NY
 Jeff's Companion Animal Shelter, Inc., Westport, MA
 La Casa Housing Corporation, Inc., Waterbury, CT
 Learning Ladder Day Care, Inc., Cortland, NY
 Lincoln and Friends, Fairfax, CA
 Maryland Volunteer Water Quality Monitoring Association Inc., Crofton, MD
 Maxie Wright's Boys Center, San Bernardino, CA
 MGS Charity, Inc., Huntington, NY
 The Nashville Foundation for Women Business Owners Inc., Nashville, TN
 National Association of Minorities in Cable Foundation, Cerritos, CA
 National Council for the Handicapped, Inc., Brooklyn, NY
 The National Museum of Artificial Limb Technology, San Francisco, CA
 Nevada Historical Automobile Society Inc., Elcajon, CA
 New Beginnings Outreach Ministries, Inc., Bronx, NY
 New Hampshire Association for the

Education of Young Children, Weare, NH
 New Hampshire Soccer Association, Nashua, NH
 New Village Productions, Inc., New York, NY
 New World Dancers and Singers, Inc., New York, NY
 New York City Society for Parenteral and Enteral Nutrition, Riverdale, NY
 North Okaloosa Arc Inc., Crestview, FL
 Onake II, Rooseveltown, NY
 Out of the Blue Theater Company, Somerville, MA
 Pacific Basin Research Institute, Rockville, MD
 Paradise Pet Shelter, Inc., Millis, MA
 Patricia Marschner Memorial for the Children of Londonderry, Londonderry, NH
 Peaceful Settlements Foundation, Boise, ID
 Peninsula Sexual Minority Youth League, Newport News, VA
 Picnic-in-the-Park, Incorporated, Concord, MA
 Pima Optimum Learning Center, Scottsdale, AZ
 Pipco Corporation, Rochester, NY
 Pittsburgh Allergy Society, Latrobe, PA
 Plainfield First Response, Plainfield, VT
 Playground in the Park, Inc., Cheshire, CT
 Point O Woods Historical Society, Summit, NJ
 Preserve Earths Threatened Ecosystems Foundation, Berkeley, CA
 PTA New York State Congress, Inc., Brentwood, NY
 Public Productions, Inc., Waltham, MA
 Rainforest Rescue, Inc., West Action, MA
 Rakka Thamm Theater Company, Inc., New York, NY
 RCLC Foundation, Inc., Riverside, CT
 Reach Out Ethiopia, Inc., Cambridge, MA
 Renaissance Intl, Inc., New York, NY
 Rochester Charity Partners, Inc., Rochester, NY
 San Diego Museum of Modern Sculpture, San Diego, CA
 Senior Citizen Association of Taiwanese Christians of Greater New York, Inc., Flushing, NY
 Shelter Homeless America, Inc., Lawrence, MA
 Sluggers Forever Inc., New Ulm, MN
 Southeast Texas Legal Clinic, Houston, TX
 St. Boniface Development Corporation, Brooklyn, NY
 Survivors United Network, Inc., Bridgehampton, NY
 Transglobal Communications Foundation, New York, NY
 Traumatic Brain Injury Resource Network, Inc., Framingham, MA
 Trenton Education Dance Institute, Inc., W. Trenton, NJ
 Trillium Performing Arts Center, Inc., Watertown, NY
 Tzu Charn Foundation, Sunnyvale, CA
 Walden-Bell Foundation, Portland, OR
 Waterville Performing Arts Centre, Inc., Waterville, ME
 West Greenwich Community Rescue Company, West Greenwich, RI
 Wilson County Education Foundation, Inc., Floresville, TX
 Worcester Institute for Students of Europe, Worcester, MA
 You Make Our Future, Inc., Danbury, CT

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

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 ap-

plies 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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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997–1 through 1997–26 will be found in Internal Revenue Bulletin 1997–27, dated July 7, 1997.

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