Internal Revenue
bulletin

Bulletin No. 1997–52
December 29, 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. 97–53, page 13.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 1998, will be 8 percent for overpayments, 9 percent for underpayments, and 11 percent for large corporate underpayments. The rate of interest paid on the portion of a corporate overpayment exceeding $10,000 is 6.5 percent.

Rev. Rul. 97–54, page 8.

Line pack gas; cushion gas. The cost of recoverable line pack gas or cushion gas is a capital expenditure and is not depreciable. The cost of nonrecoverable line pack gas or cushion gas is a capital expenditure and is depreciable.

Rev. Rul. 97–55, page 7.

Certain cost-sharing payments. The Wetlands Reserve Program, the Environmental Quality Incentives Program, and the Wildlife Habitat Incentives Program are substantially similar to the type of programs described in section 126(a)(1) through (8) of the Code so that cost-share payments made under such programs and in connection with small watersheds are within the scope of section 126(a)(9) and, thereby, cost-share payments received under the programs are eligible for exclusion from gross income to the extent permitted by section 126.

Rev. Rul. 97–56, page 10.

Section 1274A inflation-adjusted numbers for 1998. This ruling provides the dollar amounts, increased by the 1998 inflation adjustment, for section 1274A of the Code. Rev. Rul. 96–63 supplemented and superseded.

Rev. Rul. 97–57, page 16.

CPI adjustment for below-market loans—1998. The amount that section 7872(g) of the Code permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest is published and adjusted for inflation for years 1987–1998. Rev. Rul. 96–64 supplemented and superseded.

EXEMPT ORGANIZATIONS

Announcement 97–125, page 60.

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

Announcement 97–126, page 61.

A list is provided of organizations that no longer qualify as organizations for which contributions are deductible under section 170 of the Code.

EMPLOYMENT TAX

Page 12.

Railroad retirement; rate determination; quarterly. The Railroad Retirement Board has determined that the rate of tax imposed by section 3221 of the Code shall be 35 cents for the quarter beginning October 1, 1997, and 35 cents for the quarter beginning January 1, 1998.

Page 59.

Social security contribution and benefit base; domestic employee coverage threshold. The Commissioner of the Social Security Administration has announced the OASDI contribution and benefit base for remuneration paid in 1998 and self-employment income earned in taxable years beginning in 1998. The Commissioner has also determined the domestic employee coverage threshold amount for 1998.

Continued on page 4.

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

Statement of Principles of Internal Revenue Tax Administration

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

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

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

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

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

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

Part II.—Treaties and Tax Legislation.
This part is divided into two subparts as follows: Subpart A, Tax Conventions, and 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.

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

HIGHLIGHTS OF THIS ISSUE—Continued

ADMINISTRATIVE

Rev. Proc. 97-56, page 18.

Penalties; substantial understatement. Guidance is provided concerning when information shown on a return in accordance with the applicable forms and instructions will be adequate disclosure for purposes of reducing an understatement of income tax under section 6662(d) of the Code.

Rev. Proc. 97–57, page 20.

Cost-of-living adjustments for 1998. The Service provides cost-of-living adjustments for the tax rate tables for individuals, estates, and trusts, the standard deduction amounts, the personal exemption, and several other items that use the adjustment method provided for the tax rate tables. The Service also provides the adjustment for eligible long-term care premiums and another item that uses the adjustment method provided for eligible long-term care premiums.

Rev. Proc. 97–58, page 24.

Optional standard mileage rates. This procedure announces 32.5 cents as the optional rate for deducting or accounting for expenses for business use of an automobile, 14 cents as the optional rate for deducting or accounting for use of an automobile as a charitable contribution, and 10 cents as the optional rate for deducting or accounting for use of an automobile as a medical or moving expense for 1998. It provides rules for substantiating the deductible expenses of using an automobile for business, moving, medical, or charitable purposes. Rev. Proc. 96–63 superseded.

Rev. Proc. 97–59, page 31.

Per diem allowances. This procedure provides optional rules for deeming substantiated the amount of certain reimbursed traveling expenses of an employee as well as for determining the amount of deductible meals while traveling away from home. Rev. Proc. 96–64 superseded.

Rev. Proc. 97–60, page 38.

Electronic filing program; Form 1040. Participants in the 1998 Electronic Filing Program for the Form 1040 Series are informed of their obligations to the Service, taxpayers, and other participants.

Rev. Proc. 97–61, page 50.

On-line filing program; Form 1040. Participants in the 1998 On-Line Filing Program for the Form 1040 Series are informed of their obligations to the Service, taxpayers, and other participants.

Notice 97–77, page 18.

Partnership magnetic media filing requirement. Guidance is provided to partnerships having more than 100 partners regarding the requirement to file partnership tax returns on magnetic media.

Announcement 97–124, page 60.

The Service will extend the due date for federal tax deposits due to the extra federal holiday.

Announcement Relating to Court Decisions

It is the policy of the Internal Revenue Service to announce at an early date whether it will follow the holdings in certain cases. An Action on Decision is the document making such an announcement. An Action on Decision will be issued at the discretion of the Service only on unappealed issues decided adverse to the government. Generally, an Action on Decision is issued where its guidance would be helpful to Service personnel working with the same or similar issues. Unlike a Treasury Regulation or a Revenue Ruling, an Action on Decision is not an affirmative statement of Service position. It is not intended to serve as public guidance and may not be cited as precedent.

Actions on Decisions shall be relied upon within the Service only as conclusions applying the law to the facts in the particular case at the time the Action on Decision was issued. Caution should be exercised in extending the recommendation of the Action on Decision to similar cases where the facts are different. Moreover, the recommendation in the Action on Decision may be superseded by new legislation, regulations, rulings, cases, or Actions on Decisions.

Prior to 1991, the Service published acquiescence or nonacquiescence only in certain regular Tax Court opinions. The Service has expanded its acquiescence program to include other civil tax cases where guidance is determined to be helpful. Accordingly, the Service now may acquiesce or nonacquiesce in the holdings of memorandum Tax Court opinions, as well as those of the United States District Courts, Claims Court, and Circuit Courts of Appeal. Regardless of the court deciding the case, the recommendation of any Action on Decision will be published in the Internal Revenue Bulletin.

The recommendation in every Action on Decision will be summarized as acquiescence, acquiescence in result only, or nonacquiescence. Both "acquiescence" and "acquiescence in result only" mean that the Service accepts the holding of the court in a case and that the Service will follow it in disposing of cases with the same controlling facts. However, "acquiescence" indicates neither approval nor disapproval of the reasons assigned by the court for its conclusions; whereas, "acquiescence in result only" indicates disagreement or concern with some or all of those reasons. Nonacquiescence signifies that, although no further review was sought, the Service does not agree with the holding of the court and, generally, will not follow the decision in disposing of cases involving other taxpayers. In reference to an opinion of a circuit court of appeals, a nonacquiescence indicates that the Service will not follow the holding on a nationwide basis. However, the Service will recognize the precedential impact of the opinion on cases arising within the venue of the deciding circuit.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year, and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Pacific Enterprises and Subsidiaries v. Commissioner,
101 T.C. 1 (1993)[1]

William R. Jackson v. Commissioner,
108 T.C. 130 (1997)[2]

The Commissioner does not ACQUIESCE in the following decision:

Transwestern Pipeline Co. v. United States,
639 F.2d 679 (Ct.Cl. 1980)[3]

[1] Acquiescence relating to whether the cost of recoverable cushion gas and recoverable line pack gas, the gas used to maintain adequate pressure in a gas storage facility and a pipeline, respectively, is properly treated as (i) merchandise and thus included in inventory; (ii) a depreciable capital asset; or (iii) a nondepreciable capital asset.

[2] Acquiescence in result only relating to whether Termination Payments from an insurance company to a former insurance agent constitute net earnings from self-employment within the meaning of section 1402(a) of the Internal Revenue Code (the Code) so as to be subject to tax under the Self-Employment Contributions Act (SECA).

[3] Nonacquiescence relating to whether the cost of recoverable line pack gas, the gas used to charge and operate an interstate natural gas pipeline system, is properly treated as (i) merchandise and thus included in inventory; (ii) a depreciable capital asset, or (iii) a nondepreciable capital asset.

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

Section 1.—Tax Imposed

26 CFR 1.1–1: Income tax on individuals.

The Service provides adjusted tax tables for individuals, trusts, and estates for taxable years beginning in 1998 to reflect changes in the cost of living. Also adjusted is the amount of certain reductions allowed against the unearned income of minor children in computing the "kiddie tax," either on the child's return or, in the alternative, on a parent's return. The amounts used to determine whether a parent may elect to report the "kiddie tax" on the parent's return are also adjusted. See Rev. Proc. 97–57, page 20.

Section 32.—Earned Income

26 CFR 1.32–2: Earned income credit for taxable years beginning after December 31, 1978.

The Service provides inflation adjustments to the limitations on the earned income tax credit for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62–2: Reimbursements and other expense allowance arrangements.

Rules under which a reimbursement or other expense allowance arrangement for the cost of operating an automobile for business purposes will satisfy the requirements of section 62(c) of the Code as to business connection, substantiation, and returning amounts in excess of expenses. See Rev. Proc. 97–58, page 24.

Rules are set forth under which a reimbursement or other expense allowance arrangement for the cost of lodging, meals, and incidental expenses or meal and incidental expenses incurred by an employee while traveling away from home will satisfy the requirements of § 62(c) of the Code as to substantiation of the amount of expenses. See Rev. Proc. 97–59, page 31.

Section 63.—Taxable Income Defined

26 CFR 1.63–1: Change of treatment with respect to the zero bracket amount and itemized deductions.

The Service provides inflation adjustments to the standard deduction amounts (including the limitation in the case of certain dependents, and the additional standard deduction for the aged or blind) for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 68.—Overall Limitation on Itemized Deductions

The Service provides inflation adjustments to the overall limitation on itemized deductions for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 126.—Certain Cost-Sharing Payments

26 CFR 16A.126–1: Certain cost-sharing payments—In general (Temporary).

Certain cost-sharing payments. The Wetlands Reserve Program, the Environmental Quality Incentives Program, and the Wildlife Habitat Incentives Program are substantially similar to the type of programs described in section 126(a)(1) through (8) of the Code so that cost-share payments made under such programs and in connection with small watersheds are within the scope of section 126(a)(9) and, thereby, cost-share payments received under the programs are eligible for exclusion from gross income to the extent permitted by section 126.

Rev. Rul. 97–55

ISSUE

Are the Wetlands Reserve Program, the Environmental Quality Incentives Program, and the Wildlife Habitat Incentives Program substantially similar to the type of programs described in § 126(a)(1) through (8) of the Internal Revenue Code so that cost-share payments made under such programs and in connection with small watersheds are within the scope of § 126(a)(9) and, thereby, cost-share payments received under the programs are eligible for exclusion from gross income to the extent permitted by § 126?

FACTS

The Wetlands Reserve Program (WRP), authorized by Title XII of the Food Security Act of 1985, Pub. L. No. 99–198, 99 Stat. 1504, reauthorized by the Federal Agriculture Improvement and Reform Act of 1996 (the 1996 Farm Act), Pub. L. No. 104–127, 110 Stat. 995, is a voluntary wetlands conservation program to restore and protect wetlands on private property. Landowners who participate in the WRP may sell a conservation easement or enter into a restoration cost-share agreement with the Department of Agriculture to restore and protect wetlands. Under a restoration cost-share agreement, a landowner agrees to undertake approved conservation-related improvements on the property in return for a cost-share payment, generally between 75 and 100 percent of the costs for restoring the wetland. A conservation easement and a restoration cost-share agreement may be combined in one agreement with the Department of Agriculture but separate payments are made for the easement and for the cost-share agreement.

The 1996 Farm Act also establishes the Environmental Quality Incentives Program (EQIP) and the Wildlife Habitat Incentives Program (WHIP). EQIP and WHIP are administered by the Department of Agriculture. EQIP combines the functions of the Agricultural Conservation Program (ACP), the Great Plains Conservation Program (GPCP), the Water Quality Incentives Program (WQIP), and the Colorado River Basin Salinity Control Program (CRBSCP). ACP and GPCP are programs enumerated in § 126(a)(1) through (8) and the Commissioner determined in § 16A.126–1(d)(1)(D) that CRBSCP was within the scope of § 126(a)(9). WQIP was funded through and administered under ACP.

WHIP was established to help participants develop habitat for upland wildlife, wetland wildlife, threatened and endangered species, fish, and other types of wildlife. Under WHIP, landowners enter into wildlife habitat development cost-share contracts for a minimum of 10 years.

The Secretary of Agriculture has made the requisite determinations under § 126(b)(1)(A) that cost-share payments made under WRP, EQIP, and WHIP are primarily for purposes of conservation.

LAW AND ANALYSIS

Under § 126(a), gross income does not include the excludable portion of payments made to taxpayers by federal and state governments for a share of the cost of improvements to property under cer-

tain conservation programs set forth in § 126(a)(1) through (8). Under § 126-(a)(9), programs affecting small watersheds are eligible for § 126 treatment if they are administered by the Secretary of Agriculture and are determined by the Secretary of the Treasury or the Secretary's delegate to be substantially similar to the type of programs described in § 126(a)(1) through (8). Even if the Secretary of the Treasury determines that a particular program is within the scope of § 126(a)(9), not all cost-share payments under such program will qualify for the exclusion under § 126. In addition to the determination requirement, the specific project must be with respect to a small watershed and then only the "excludable portion" of any payment can qualify for exclusion. See §§ 126(b)(1), 16A.126–1(b)(5) and 16A.126–1(d)(3) for the definitions of "excludable portion" and "small watershed."

HOLDING

The Commissioner has determined that WRP, EQIP, and WHIP are substantially similar to the type of programs described in § 126(a)(1) through (8) so that cost-share payments made under such programs and in connection with small watersheds are within the scope of § 126(a)(9) and, thereby, cost-share payments received under the programs are eligible for exclusion from gross income to the extent permitted by § 126. See § 16A.126–1 to determine what portion, if any, of the cost-share payments are excludable from gross income under § 126.

DRAFTING INFORMATION

The principal authors of this revenue ruling are Leslie Finlow and Lisa Shuman of the Office of Assistant Chief Counsel (Passthroughs and Special Industries). For further information regarding this revenue ruling contact Ms. Shuman at (202) 622-3120 (not a toll-free call).

Section 132.—Certain Fringe Benefits

The Service provides inflation adjustments to the limitation on the exclusion of income for a qualified transportation fringe for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 135.—Income From United States Savings Bonds Used To Pay Higher Education Tuition and Fees

The Service provides an inflation adjustment to the limitation on the exclusion of income from United States savings bonds for taxpayers who pay qualified higher education expenses for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 151.—Allowance of Deductions for Personal Exemptions

26 CFR 1.151–4: Amount of deduction for each exemption under section 151.

The Service provides inflation adjustments to the personal exemption and to the threshold amounts of adjusted gross income above which the exemption amount phases out for taxable years beginning in 1998. See Rev.Proc. 97–57, page 20.

Section 162.—Trade or Business Expenses

26 CFR 1.162–17: Reporting and substantiation of certain business expenses of employees.

Rules are set forth for substantiating the amount of a deduction or expense for business use of an automobile that most nearly represents current costs. See Rev. Proc. 97–58, page 24.

Rules are set forth for substantiating the amount of a deduction or expense for lodging, meals, and incidental expenses or meal and incidental expenses incurred while traveling away from home that most nearly represents current costs. See Rev. Proc. 97–59, page 31.

Section 167.—Depreciation

26 CFR 1.167(a) –1: Depreciation in general.

The cost of recoverable line pack gas or cushion gas is not depreciable, and the cost of nonrecoverable line pack gas or cushion gas is depreciable. See Rev. Rul. 97–54, on this page.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170–1: Charitable, etc., contributions and gifts; allowance of deductions.

The Service provides inflation adjustments to the "insubstantial benefit" guidelines for calendar year 1998. Under the guidelines, a charitable contribution is fully deductible even though the contributor receives "insubstantial benefits" from the charity. See Rev. Proc. 97–57, page 20.

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26 CFR 1.170A–1: Charitable, etc., contributions and gifts; allowance of deduction.

Rules are set forth for substantiating the amount of a deduction or expense for charitable use of an automobile. See Rev. Proc. 97–58, page 24.

Section 213.—Medical, Dental, Etc., Expenses

The Service provides an inflation adjustment to the limitation on the amount of eligible long-term care premiums includible in the term "medical care" for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

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26 CFR 1.213–1: Medical, dental, etc., expenses.

Rules are set forth for substantiating the amount of a deduction or expense for use of an automobile to obtain medical services. See Rev. Proc. 97–58, page 24.

Section 217.—Moving Expenses

26 CFR 1.217–2: Moving expenses.

Rules are set forth for substantiating the amount of a deduction or expense for use of an automobile as part of a move. See Rev. Proc. 97–58, page 24.

Section 263.—Capital Expenditures

26 CFR 1.263(a)–1: Capital expenditures; in general.

The cost of recoverable and nonrecoverable line pack gas or cushion gas is a capital expenditure. See Rev. Rul. 97–54, on this page.

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26 CFR 1.263(a)–1: Capital expenditures; in general.
(Also sections 167, 168, 471; 1.167(a)–1, 1.471–1.)

Line pack gas; cushion gas. The cost of recoverable line pack gas or cushion gas is a capital expenditure and is not depreciable. The cost of nonrecoverable line pack gas or cushion gas is a capital expenditure and is depreciable.

Rev. Rul. 97–54

ISSUES

(1) Is the cost of "line pack gas" or "cushion gas" a capital expenditure under § 263 of the Internal Revenue Code or an

amount that is included in inventory under § 471?

(2) If the cost of "line pack gas" or "cushion gas" is a capital expenditure under § 263, is that cost depreciable under §§ 167 and 168?

FACTS

"Line pack gas" is the minimum volume of natural gas necessary to provide the pressure to facilitate the flow of gas through a pipeline. "Cushion gas" is the minimum volume of natural gas necessary to provide the pressure to facilitate the flow of gas from a storage reservoir to a pipeline. Recoverable line pack gas and recoverable cushion gas will be available for sale or other use upon the abandonment of the pipeline or storage reservoir, respectively. Unrecoverable line pack gas and unrecoverable cushion gas will not be available for sale or other use upon the abandonment of the pipeline or storage reservoir, but will become obsolete with that abandonment.

LAW AND ANALYSIS

Section 263(a) provides that no deduction shall be allowed for amounts paid out for permanent improvements or betterments made to increase the value of any property or estate.

Section 1.263(a)–2 of the Income Tax Regulations provides that a "capital expenditure" includes the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the tax year.

Section 167(a) provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business or held for the production of income.

Generally, for tangible property, the depreciation deduction under § 167(a) is determined under § 168 by using the applicable depreciation method, the applicable recovery period, and the applicable convention.

Section 471 provides that whenever, in the opinion of the Secretary, the use of inventories is necessary in order clearly to determine the income of any taxpayer, inventories shall be taken by that taxpayer, on the basis the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

Section 1.471–1 provides that in order to reflect income correctly, inventories at the beginning and end of each tax year are necessary in every case in which the production, purchase, or sale of merchandise is an income-producing factor. Inventories should include all finished and partly finished goods and, in the case of raw materials and supplies, only those that have been acquired for sale or that will physically become a part of merchandise intended for sale.

Rev. Rul. 68–620, 1968–2 C.B. 199, *amplified* by Rev. Rul. 78–352, 1978–2 C.B. 168, holds that line pack gas is merchandise in transit that is intended to be sold to customers and therefore must be included in the inventory of the taxpayer.

Rev. Rul. 75–233, 1975–1 C.B. 95, holds that the cost of unrecoverable cushion gas is a capital expenditure under § 263, which is recoverable through an annual depreciation deduction under § 167.

With respect to both line pack gas and cushion gas, several court decisions have considered the capital expenditure-versus-inventory issue, as well as the depreciation issue. In *Pacific Enterprises v. Commissioner*, 101 T.C. 1 (1993), the United States Tax Court held that the costs of line pack gas and cushion gas are capital expenditures. *Accord Transwestern Pipeline Co. v. United States*, 639 F.2d 679 (Ct.Cl. 1980), regarding line pack gas; *Arkla, Inc. v. United States*, 765 F.2d 487 (5th Cir. 1985), regarding cushion gas. The United States Court of Appeals for the Fifth Circuit in *Arkla* further held that recoverable cushion gas was not subject to depreciation because it was not subject to exhaustion, wear, tear, or obsolescence. *Accord Washington Energy Co. v. United States*, 94 F.3d 1557 (Fed. Cir. 1996). The Fifth Circuit in *Arkla* distinguished unrecoverable cushion gas as being subject to depreciation because that gas will become obsolete along with the storage facility. *Accord* Rev. Rul. 75-233. Finally, in *Arkla, Inc. v. United States*, 37 F.3d 621 (Fed. Cir. 1994), the United States Court of Appeals for the Federal Circuit held that line pack gas and cushion gas are treated the same for purposes of depreciation. *Accord Washington Energy Co. v. United States*, 94 F.3d 1557.

Line pack gas or cushion gas is recoverable if it will be available for sale or other use upon abandonment of a pipeline or storage reservoir. *See Arkla, Inc. v. United States*, 765 F.2d at 490. The Service will treat line pack gas or cushion gas as being available for sale or other use to the extent that such gas will be recovered from an abandoned pipeline or storage reservoir pursuant to a plan, a requirement of law, or economic feasibility, whichever method projects the greatest actual recovery of such gas.

The Service will follow the court decisions cited in this revenue ruling to the extent they hold that the cost of line pack gas or cushion gas is a capital expenditure, the cost of recoverable line pack gas or recoverable cushion gas is not depreciable, and the cost of unrecoverable line pack gas or unrecoverable cushion gas is depreciable.

HOLDINGS

(1) The cost of line pack gas or cushion gas is a capital expenditure under § 263.

(2) The cost of recoverable line pack gas or recoverable cushion gas is not depreciable, but the cost of unrecoverable line pack gas or unrecoverable cushion gas is depreciable under §§ 167 and 168. The Service will treat line pack gas or cushion gas as recoverable to the extent that such gas will be recovered from an abandoned pipeline or storage reservoir pursuant to a plan, a requirement of law, or economic feasibility, whichever method projects the greatest actual recovery of such gas.

APPLICATION

Any change in a taxpayer's treatment of the costs of line pack gas or cushion gas to conform with this revenue ruling is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply. A taxpayer wanting to change its method of accounting for the cost of line pack gas or cushion gas to conform with this revenue ruling must follow the automatic change in accounting method provisions of Rev. Proc. 97–37, 1997–33 I.R.B. 18.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 68–620 and Rev. Rul. 78–352 are revoked. Rev. Rul. 75–233 is superseded. Rev. Proc. 97–37 is amplified to include this change in the Appendix.

PROSPECTIVE APPLICATION

The Service will not require a taxpayer to change its method of accounting to comply with the holding that the cost of line pack gas or recoverable cushion gas is a capital expenditure for any taxable year beginning before December 29, 1997. In addition, the Service will not require a taxpayer to change its method of accounting to comply with the holding for determining the amount of recoverable line pack gas or recoverable cushion gas for any taxable year beginning before December 29, 1997, provided the method used by the taxpayer projects recoverable line pack gas or recoverable cushion gas in an amount equal to or greater than an amount that would be projected using an economic feasibility of recovery standard.

DRAFTING INFORMATION

The principal author of this revenue ruling is Jennifer L. Nuding of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information concerning this revenue ruling, contact Ms. Nuding at (202) 622-4970 (not a toll-free call).

Section 267.—Losses, Expenses, and Interest With Respect to Transactions Between Related Taxpayers

26 CFR 1.267(a)–1: Deductions disallowed.

When a payor provides a per diem allowance to an employee who is a related party, the rules set forth for the deemed substantiation to the payor of the amount of the employee's ordinary and necessary business expenses for lodging, meal, and/or incidental expenses incurred while traveling away from home, do not apply. See Rev. Proc. 97–59, page 31.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274(d)–1(a): Substantiation requirements.

Simplified optional method for substantiating the amount of a deduction or expense for business use of an automobile. See Rev. Proc. 97–58, page 24.

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26 CFR 1.274–5T: Substantiation requirements (temporary).

Simplified optional method for substantiating the amount of a deduction or expense for business use of an automobile. See Rev. Proc. 97–58, page 24.

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26 CFR 1.274(d)–1(a): Substantiation requirements.

Rules are set forth for substantiating the amount of ordinary and necessary business expense of an employee for lodging, meals, and incidental expenses or meal and incidental expenses incurred while traveling away from home when a payor provides a per diem allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. See Rev. Proc. 97–59, page 31.

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26 CFR 1.274–5T: Substantiation requirements (temporary).

Rules are set forth for substantiating the amount of ordinary and necessary business expense of an employee for lodging, meals, and incidental expenses or meal and incidental expenses incurred while traveling away from home when a payor provides a per diem allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Rules are also set forth for an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. See Rev. Proc. 97–59, page 31.

Section 471—General Rule for Inventories

26 CFR 1.471–1: Need for inventories.

The cost of recoverable and nonrecoverable line pack gas or cushion gas is a capital expenditure. Line pack gas or cushion gas in not inventory. See Rev. Rul. 97–54, page 8.

Section 483.—Interest on Certain Deferred Payments

26 CFR 1.483–1: Computation of interest on certain deferred payments.

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 1998 calendar year. See Rev. Rul. 97–56, page 11.

Section 512.—Unrelated Business Taxable Income

The Service provides an inflation adjustment to the maximum amount of annual dues that can be paid to certain agricultural or horticultural organizations without any portion being treated as unrelated trade or business income by reason of any benefits or privileges available to members for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 513.—Unrelated Trade or Business

The Service provides an inflation adjustment to the maximum amount of a "low cost article" for taxable years beginning in 1998. Funds raised through a charity's distribution of "low cost articles" will not be treated as unrelated business income to the charity. See Rev. Proc. 97–57, page 20.

Section 877.—Expatriation to Avoid Tax

The Service provides an inflation adjustment to amounts used to determine whether an individual's loss of United States citizenship had the avoidance of United States taxes as one of its principal purposes for calendar year 1998. See Rev. Proc. 97–57, page 20.

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

26 CFR 1.1274A–1: Special rules for certain transactions where stated principal amount does not exceed $2,800,000.

As defined by section 1274A, the definitions for both "qualified debt instruments" and "cash method debt instruments" have dollar ceilings on the stated principal amount. The limits to the stated principal amount are adjusted for inflation for sales or exchanges occurring in the 1998 calendar year. See Rev. Rul. 97–56, page 10.

Section 1274A.—Special Rules for Certain Transactions Where Stated Principal Amount Does Not Exceed $2,800,000

(Also §§ 1274, 483; 1.1274A–1)

Section 1274A inflation-adjusted numbers for 1998. This ruling provides the dollar amounts, increased by the 1998 inflation adjustment, for section 1274A of the Code. Rev. Rul. 96–63 supplemented and superseded.

Rev. Rul. 97–56

This revenue ruling provides the dollar amounts, increased by the 1998 inflation adjustment, for § 1274A of the Internal Revenue Code.

BACKGROUND

In general, §§ 483 and 1274 of the Code determine the principal amount of a debt instrument given in consideration for the sale or exchange of nonpublicly traded property. In addition, any interest on a debt instrument subject to § 1274 is taken into account under the original issue discount provisions of the Code. Section 1274A, however, modifies the rules under §§ 483 and 1274 for certain types of debt instruments.

In the case of a "qualified debt instrument," the discount rate used for purposes of §§ 483 and 1274 of the Code may not exceed 9 percent, compounded semiannually. Section 1274A(b) defines a qualified debt instrument as any debt instrument given in consideration for the sale or exchange of property (other than new § 38 property within the meaning of § 48(b), as in effect on the day before the date of enactment of the Revenue Reconciliation Act of 1990) if the stated principal amount of the instrument does not exceed the amount specified in § 1274A(b). For debt instruments arising out of sales or exchanges before January 1, 1990, this amount is $2,800,000.

In the case of a "cash method debt instrument," as defined in § 1274A(c) of the Code, the borrower and lender may elect to use the cash receipts and disbursements method of accounting. In particular, for any cash method debt instrument, § 1274 does not apply, and interest on the instrument is accounted for by both the borrower and the lender under the cash method of accounting. A cash method debt instrument is a qualified debt instrument that meets the following additional requirements: (A) In the case of instruments arising out of sales or exchanges before January 1, 1990, the stated principal amount does not exceed $2,000,000, (B) The lender does not use an accrual method of accounting and is not a dealer with respect to the property sold or exchanged, (C) Section 1274 would have applied to the debt instrument but for an election under § 1274A(c); and (D) An election under § 1274A(c) is jointly made with respect to the debt instrument by the borrower and lender. Section 1.1274A–1(c)(1) of the Income Tax Regulations provides rules concerning the time for, and manner of, making this election.

Section 1274A(d)(2) of the Code provides that, for any debt instrument arising out of a sale or exchange during any calendar year after 1989, the dollar amounts stated in § 1274A(b) and § 1274A(c)-(2)(A) are increased by the inflation adjustment for the calendar year. Any increase due to the inflation adjustment is rounded to the nearest multiple of $100 (or, if the increase is a multiple of $50 and not of $100, the increase is increased to the nearest multiple of $100). The inflation adjustment for any calendar year is the percentage (if any) by which the CPI for the preceding calendar year exceeds the CPI for calendar year 1988. Section 1274A(d)(2)(B) defines the CPI for any calendar year as the average of the Consumer Price Index as of the close of the 12-month period ending on September 30 of that calendar year.

INFLATION-ADJUSTED AMOUNTS

For debt instruments arising out of sales or exchanges after December 31, 1989, the inflation-adjusted amounts under § 1274A are shown in Table 1.

Rev. Rul. 97–56 Table 1
Inflation-Adjusted Amounts Under § 1274A

Calendar Year of Sale or Exchange	1274A(b) Amount (qualified debt instrument)	1274A(c)(2)(A) Amount (cash method debt instrument)
1990	$2,933,200	$2,095,100
1991	$3,079,600	$2,199,700
1992	$3,234,900	$2,310,600
1993	$3,332,400	$2,380,300
1994	$3,433,500	$2,452,500
1995	$3,523,600	$2,516,900
1996	$3,622,500	$2,587,500
1997	$3,723,800	$2,659,900
1998	$3,823,100	$2,730,800

Note: These inflation adjustments were computed using the All-Urban, Consumer Price Index, 1982-1984 base, published by the Bureau of Labor Statistics.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 96-63, 1996-2 C.B. 83, is supplemented and superseded.

DRAFTING INFORMATION

The principal author of this revenue ruling is David B. Silber of the Office of the Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling contact Mr. Silber on (202) 622-3930 (not a toll-free call).

Section 3221.—Rate of Tax

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning October 1, 1997, shall be at the rate of 35 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning October 1, 1997, 31.4 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 68.6 percent of the taxes collected under such Sections 3211 (b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated: August 25, 1997.

By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on September 2, 1997, 8:45 a.m., and published in the issue of the Federal Register for September 3, 1997, 62 F.R. 46526)

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C., Section 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning January 1, 1998, shall be at the rate of 35 cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning January 1, 1998, 31.6 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 68.4 percent of the taxes collected under such Sections 3211 (b) and 3221(c) plus 100 percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated: December 2, 1997.

By Authority of the Board.

Beatrice Ezerski,
Secretary to the Board.

(Filed by the Office of the Federal Register on December 9, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 10, 1997, 62 F.R. 65108)

Section 4001.—Passenger Vehicles

The Service provides an inflation adjustment to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 1998. See Rev. Proc. 97–57, page 20.

Section 4003.—Special Rules

The Service provides an inflation adjustment to the price above which a passenger vehicle becomes subject to an excise tax for transactions occurring in calendar year 1998. (Price includes the price of installation of parts or accessories on a passenger vehicle within six months of the date after the vehicle was first placed in service.) See Rev. Proc. 97–57, page 20.

Section 6012.—Persons Required To Make Returns of Income

26 CFR 1.6012–1: Individuals required to make returns of income.

The Service provides adjusted tax tables for individuals and trusts and estates for taxable years beginning in 1998 to reflect changes in the cost of living. See Rev. Proc. 97–57, page 20.

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26 CFR 1.6012–5: Composite return in lieu of specified form.

For the requirements for participation in the 1998 Electronic Filing Program for the Form 1040 Series, see Rev. Proc. 97–60, page 38.

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26 CFR 1.6012–5: Composite return in lieu of specified form.

For the requirements for participation in the 1998 On-Line Filing Program for the Form 1040 Series, see Rev. Proc. 97–61, page 50.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013–1: Joint returns.

The Service provides adjusted tax tables for individuals for taxable years beginning in 1998 to reflect changes in the cost of living. See Rev. Proc. 97–57, page 20.

Section 6033.—Returns by Exempt Organizations

The Service provides an inflation adjustment to the amount of dues certain exempt organizations can charge and still be excepted from the reporting requirements for exempt organizations with nondeductible lobbying expenditures for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 6039F.—Notice of Large Gifts Received From Foreign Persons

The Service provides an inflation adjustment to the amount of gifts in a taxable year from certain foreign person(s) that may trigger a reporting requirement for a United States person for taxable years beginning in 1998. See Rev. Proc. 97–57, page 20.

Section 6061.—Signing of Returns and Other Documents

26 CFR 1.6061–1: Signing of returns and other documents by individuals.

For the requirements for participation in the 1998 Electronic Filing Program for the Form 1040 Series, see Rev. Proc. 97–60, page 38.

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26 CFR 1.6061–1: Signing of returns and other documents by individuals.

For the requirements for participation in the 1998 On-Line Filing Program for the Form 1040 Series, see Rev. Proc. 97–61, page 50.

Section 6334.—Property Exempt From Levy

The Service provides inflation adjustments to the value of certain property exempt from levy; for example, fuel, provisions, and personal effects as well as books and tools of a trade, business, or profession for calendar year 1998. See Rev. Proc. 97–57, page 20.

Section 6621.— Determination of Interest Rate

26 CFR 301.6621–1: Interest rate.

Interest rates; underpayments and overpayments. The rate of interest determined under section 6621 of the Code for the calendar quarter beginning January 1, 1998, will be 8 percent for overpayments, 9 percent for underpayments, and 11 percent for large corporate underpayments. The rate of interst paid on the portion of a corporate overpayment exceeding $10,000 is 6.5 percent.

Rev. Rul. 97–53

Section 6621 of the Internal Revenue Code establishes different rates for interest on tax overpayments and interest on tax underpayments. Under § 6621(a)(1), the overpayment rate is the sum of the federal short-term rate plus 2 percentage points, except the rate for the portion of a corporate overpayment of tax exceeding $10,000 for a taxable period is the sum of the federal short-term rate plus 0.5 of a percentage point for interest computations made after December 31, 1994. Under § 6621(a)(2), the underpayment rate is the sum of the federal short-term rate plus 3 percentage points.

Section 6621(c) provides that for purposes of interest payable under § 6601 on any large corporate underpayment, the underpayment rate under § 6621(a)(2) is determined by substituting "5 percentage points" for "3 percentage points." See § 6621(c) and § 301.6621–3 of the Regulations on Procedure and Administration for the definition of a large corporate underpayment and for the rules for determining the applicable date. Section 6621(c) and § 301.6621–3 are generally effective for periods after December 31, 1990.

Section 6621(b)(1) provides that the Secretary will determine the federal short-term rate for the first month in each calendar quarter.

Section 6621(b)(2)(A) provides that the federal short-term rate determined under § 6621(b)(1) for any month applies during the first calendar quarter beginning after such month.

Section 6621(b)(2)(B) provides that in determining the addition to tax under § 6654 for failure to pay estimated tax for any taxable year, the federal short-term rate that applies during the third month following such taxable year also applies during the first 15 days of the fourth month following such taxable year.

Section 6621(b)(3) provides that the federal short-term rate for any month is the federal short-term rate determined during such month by the Secretary in accordance with § 1274(d), rounded to the nearest full percent (or, if a multiple of 1/2 of 1 percent, the rate is increased to the next highest full percent).

Notice 88–59, 1988-1 C.B. 546, announced that, in determining the quarterly interest rates to be used for overpayments and underpayments of tax under § 6621, the Internal Revenue Service will use the federal short-term rate based on daily compounding because that rate is most consistent with § 6621 which, pursuant to § 6622, is subject to daily compounding.

Rounded to the nearest full percent, the federal short-term rate based on daily compounding determined during the month of October 1997 is 6 percent. Accordingly, an overpayment rate of 8 percent and an underpayment rate of 9 percent are established for the calendar quarter beginning January 1, 1998. The overpayment rate for the portion of a corporate overpayment exceeding $10,000 for the calendar quarter beginning January 1, 1998, is 6.5 percent. The underpayment rate for large corporate underpayments for the calendar quarter beginning January 1, 1998, is 11 percent. These rates apply to amounts bearing interest during that calendar quarter.

The 9 percent rate also applies to estimated tax underpayments for the first calendar quarter in 1998 and for the first 15 days in April 1998.

Interest factors for daily compound interest for annual rates of 6.5 percent, 8 percent, 9 percent, and 11 percent are published in Tables 18, 21, 23, and 27 of Rev. Proc. 95–17, 1995–1 C.B. 556, 572, 575, 577, and 581.

Annual interest rates to be compounded daily pursuant to § 6622 that apply for prior periods are set forth in the tables accompanying this revenue ruling.

DRAFTING INFORMATION

The principal author of this revenue ruling is Raymond Bailey of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Bailey on (202) 622-6226 (not a toll-free call).

TABLE OF INTEREST RATES

PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS – PERIOD

	RATE	DAILY RATE TABLE IN 1995-1 C.B.
Before Jul. 1, 1975	6%	Table 2, pg. 557
Jul. 1, 1975—Jan. 31, 1976	9%	Table 4, pg. 559
Feb. 1, 1976—Jan. 31, 1978	7%	Table 3, pg. 558
Feb. 1, 1978—Jan. 31, 1980	6%	Table 2, pg. 557
Feb. 1, 1980—Jan. 31, 1982	12%	Table 5, pg. 560
Feb. 1, 1982—Dec. 31, 1982	20%	Table 6, pg. 560
Jan. 1, 1983—Jun. 30, 1983	16%	Table 37, pg. 591
Jul. 1, 1983—Dec. 31, 1983	11%	Table 27, pg. 581
Jan. 1, 1984—Jun. 30, 1984	11%	Table 75, pg. 629

TABLE OF INTEREST RATES – Continued

PERIODS BEFORE JUL. 1, 1975 - PERIODS ENDING DEC. 31, 1986

OVERPAYMENTS AND UNDERPAYMENTS – PERIOD

	RATE	DAILY RATE TABLE IN 1995-1 C.B.
Jul. 1, 1984—Dec. 31, 1984	11%	Table 75, pg. 629
Jan. 1, 1985—Jun. 30, 1985	13%	Table 31, pg. 585
Jul. 1, 1985—Dec. 31, 1985	11%	Table 27, pg. 581
Jan. 1, 1986—Jun. 30, 1986	10%	Table 25 pg. 579
Jul. 1, 1986—Dec. 31, 1986	9%	Table 23, pg. 577

TABLE OF INTEREST RATES

FROM JAN. 1, 1987 - PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
		RATE TABLE PG 1995-1 C.B.			RATE TABLE PG 1995-1 C.B.	
Jan. 1, 1987—Mar. 31, 1987	8%	21	575	9%	23	577
Apr. 1, 1987—Jun. 30, 1987	8%	21	575	9%	23	577
Jul. 1, 1987—Sep. 30, 1987	8%	21	575	9%	23	577
Oct. 1, 1987—Dec. 31, 1987	9%	23	577	10%	25	579
Jan. 1, 1988—Mar. 31, 1988	10%	73	627	11%	75	629
Apr. 1, 1988—Jun. 30, 1988	9%	71	625	10%	73	627
Jul. 1, 1988—Sep. 30, 1988	9%	71	625	10%	73	627
Oct. 1, 1988—Dec. 31, 1988	10%	73	627	11%	75	629
Jan. 1, 1989—Mar. 31, 1989	10%	25	579	11%	27	581
Apr. 1, 1989—Jun. 30, 1989	11%	27	581	12%	29	583
Jul. 1, 1989—Sep. 30, 1989	11%	27	581	12%	29	583
Oct. 1, 1989—Dec. 31, 1989	10%	25	579	11%	27	581
Jan. 1, 1990—Mar. 31, 1990	10%	25	579	11%	27	581
Apr. 1, 1990—Jun. 30, 1990	10%	25	579	11%	27	581
Jul. 1, 1990—Sep. 30, 1990	10%	25	579	11%	27	581
Oct. 1, 1990—Dec. 31, 1990	10%	25	579	11%	27	581
Jan. 1, 1991—Mar. 31, 1991	10%	25	579	11%	27	581
Apr. 1, 1991—Jun. 30, 1991	9%	23	577	10%	25	579
Jul. 1, 1991—Sep. 30, 1991	9%	23	577	10%	25	579
Oct. 1, 1991—Dec. 31, 1991	9%	23	577	10%	25	579
Jan. 1, 1992—Mar. 31, 1992	8%	69	623	9%	71	625
Apr. 1, 1992—Jun. 30, 1992	7%	67	621	8%	69	623
Jul. 1, 1992—Sep. 30, 1992	7%	67	621	8%	69	623
Oct. 1, 1992—Dec. 31, 1992	6%	65	619	7%	67	621
Jan. 1, 1993—Mar. 31, 1993	6%	17	571	7%	19	573
Apr. 1, 1993—Jun. 30, 1993	6%	17	571	7%	19	573
Jul. 1, 1993—Sep. 30, 1993	6%	17	571	7%	19	573
Oct. 1, 1993—Dec. 31, 1993	6%	17	571	7%	19	573
Jan. 1, 1994—Mar. 31, 1994	6%	17	571	7%	19	573
Apr. 1, 1994—Jun. 30, 1994	6%	17	571	7%	19	573
Jul. 1, 1994—Sep. 30, 1994	7%	19	573	8%	21	575
Oct. 1, 1994—Dec. 31, 1994	8%	21	575	9%	23	577
Jan. 1, 1995—Mar. 31, 1995	8%	21	575	9%	23	577

TABLE OF INTEREST RATES – Continued

FROM JAN. 1, 1987 - PRESENT

	OVERPAYMENTS			UNDERPAYMENTS		
		RATE TABLE PG 1995-1 C.B.			RATE TABLE PG 1995-1 C.B.	
Apr. 1, 1995—Jun. 30, 1995	9%	23	577	10%	25	579
Jul. 1, 1995—Sep. 30, 1995	8%	21	575	9%	23	577
Oct. 1, 1995—Dec. 31, 1995	8%	21	575	9%	23	577
Jan. 1, 1996—Mar. 31, 1996	8%	69	623	9%	71	625
Apr. 1, 1996—Jun. 30, 1996	7%	67	621	8%	69	623
Jul. 1, 1996—Sep. 30, 1996	8%	69	623	9%	71	625
Oct. 1, 1996—Dec. 31, 1996	8%	69	623	9%	71	625
Jan. 1, 1997—Mar. 31, 1997	8%	21	575	9%	23	577
Apr. 1, 1997—Jun. 30, 1997	8%	21	575	9%	23	577
Jul. 1, 1997—Sep. 30, 1997	8%	21	575	9%	23	577
Oct. 1, 1997—Dec. 31, 1997	8%	21	575	9%	23	577
Jan. 1, 1998—Mar. 31, 1998	8%	21	575	9%	23	577

TABLE OF INTEREST RATES FOR

LARGE CORPORATE UNDERPAYMENTS

FROM JANUARY 1, 1991 - PRESENT

		RATE TABLE PG 1995-1 C.B.	
Jan. 1, 1991—Mar. 31, 1991	13%	31	585
Apr. 1, 1991—Jun. 30, 1991	12%	29	583
Jul. 1, 1991—Sep. 30, 1991	12%	29	583
Oct. 1, 1991—Dec. 31, 1991	12%	29	583
Jan. 1, 1992—Mar. 31, 1992	11%	75	629
Apr. 1, 1992—Jun. 30, 1992	10%	73	627
Jul. 1, 1992—Sep. 30, 1992	10%	73	627
Oct. 1, 1992—Dec. 31, 1992	9%	71	625
Jan. 1, 1993—Mar. 31, 1993	9%	23	577
Apr. 1, 1993—Jun. 30, 1993	9%	23	577
Jul. 1, 1993—Sep. 30, 1993	9%	23	577
Oct. 1, 1993—Dec. 31, 1993	9%	23	577
Jan. 1, 1994—Mar. 31, 1994	9%	23	577
Apr. 1, 1994—Jun. 30, 1994	9%	23	577
Jul. 1, 1994—Sep. 30, 1994	10%	25	579
Oct. 1, 1994—Dec. 31, 1994	11%	27	581
Jan. 1, 1995—Mar. 31, 1995	11%	27	581
Apr. 1, 1995—Jun. 30, 1995	12%	29	583
Jul. 1, 1995—Sep. 30, 1995	11%	27	581
Oct. 1, 1995—Dec. 31, 1995	11%	27	581
Jan. 1, 1996—Mar. 31, 1996	11%	75	629
Apr. 1, 1996—Jun. 30, 1996	10%	73	627
Jul. 1, 1996—Sep. 30, 1996	11%	75	629
Oct. 1, 1996—Dec. 31, 1996	11%	75	629
Jan. 1, 1997—Mar. 31, 1997	11%	27	581
Apr. 1, 1997—Jun. 30, 1997	11%	27	581
Jul. 1, 1997—Sep. 30, 1997	11%	27	581
Oct. 1, 1997—Dec. 31, 1997	11%	27	581
Jan. 1, 1998—Mar. 31, 1998	11%	27	581

TABLE OF INTEREST RATES FOR CORPORATE
OVERPAYMENTS EXCEEDING $10,000
FROM JANUARY 1, 1995 - PRESENT

		RATE TABLE	PG 1995-1 C.B.
Jan. 1, 1995—Mar. 31, 1995	6.5%	18	572
Apr. 1, 1995—Jun. 30, 1995	7.5%	20	574
Jul. 1, 1995—Sep. 30, 1995	6.5%	18	572
Oct. 1, 1995—Dec. 31, 1995	6.5%	18	572
Jan. 1, 1996—Mar. 31, 1996	6.5%	66	620
Apr. 1, 1996—Jun. 30, 1996	5.5%	64	618
Jul. 1, 1996—Sep. 30, 1996	6.5%	66	620
Oct. 1, 1996—Dec. 31, 1996	6.5%	66	620
Jan. 1, 1997—Mar. 31, 1997	6.5%	18	572
Apr. 1, 1997—Jun. 30, 1997	6.5%	18	572
Jul. 1, 1997—Sep. 30, 1997	6.5%	18	572
Oct. 1, 1997—Dec. 31, 1997	6.5%	18	572
Jan. 1, 1998—Mar. 31, 1998	6.5%	18	572

Section 7430.—Awarding of Costs and Certain Fees

The Service provides an inflation adjustment to the hourly limit on attorney fees that may be awarded in a judgment or settlement of an administrative or judicial proceeding concerning the determination, collection, or refund of tax, interest, or penalty for calendar year 1998. See Rev. Proc. 97–57, page 20.

Section 7702B.—Treatment of Qualified Long-Term Care Insurance

The Service provides an inflation adjustment to the stated dollar amount of the per diem limitation regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual for calendar year 1998. See Rev. Proc. 97–57, page 20.

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

CPI adjustment for below-market loans–1998. The amount that section 7872(g) of the Code permits a taxpayer to lend to a qualified continuing care facility without incurring imputed interest is published and adjusted for inflation for years 1987–1998. Rev. Rul. 96–64 supplemented and superseded.

Rev. Rul. 97–57

This revenue ruling publishes the amount that § 7872(g) of the Internal Revenue Code permits a taxpayer to lend to a qualifying continuing care facility without incurring imputed interest. The amount is adjusted for inflation for the years after 1986.

Section 7872 of the Code generally treats loans bearing a below-market interest rate as if they bore interest at the market rate.

Section 7872(g)(1) of the Code provides that, in general, § 7872 does not apply for any calendar year to any below-market loan made by a lender to a qualified continuing care facility pursuant to a continuing care contract if the lender (or the lender's spouse) attains age 65 before the close of the year.

Section 7872(g)(2) of the Code provides that, in the case of loans made after October 11, 1985, and before 1987, § 7872(g)(1) applies only to the extent that the aggregate outstanding amount of any loan to which § 7872(g) applies (determined without regard to § 7872(g)(2)), when added to the aggregate outstanding amount of all other previous loans between the lender (or the lender's spouse) and any qualified continuing care facility to which § 7872(g)(1) applies, does not exceed $90,000.

Section 7872(g)(5) of the Code provides that, for loans made during any calendar year after 1986 to which § 7872(g)(1) applies, the $90,000 limit specified in § 7872(g)(2) is increased by an inflation adjustment. The inflation adjustment for any calendar year is the percentage (if any) by which the Consumer Price Index (CPI) for the preceding calendar year exceeds the CPI for calendar year 1985. Section 7872(g)(5) states that the CPI for any calendar year is the average of the CPI as of the close of the 12-month period ending on September 30 of that calendar year.

Rev. Rul. 96–64, 1996-2 C.B. 199, publishes the amount specified in § 7872(g)(2) of the Code, increased by the inflation adjustment, for the years 1987-97.

Table 1 sets forth the amount specified in § 7872(g)(2) of the Code. The amount is increased by the inflation adjustment for the years 1987–98.

REV. RUL. 97–57 TABLE 1

Limit under 7872(g)(2)

Year	Amount
Before 1987	$ 90,000
1987	$ 92,200
1988	$ 94,800
1989	$ 98,800
1990	$103,500
1991	$108,600
1992	$114,100
1993	$117,500
1994	$121,100
1995	$124,300
1996	$127,800
1997	$131,300
1998	$134,800

Note: These inflation adjustments were computed using the All-Urban, Consumer Price Index 1982-1984 base, published by the Bureau of Labor Statistics.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 96–64, 1996–2 C.B. 199, is supplemented and superseded.

DRAFTING INFORMATION

The author of this revenue ruling is David B. Silber of the Office of Assistant Chief Counsel (Financial Institutions and Products). For further information regarding this revenue ruling, contact Mr. Silber on (202) 622-3930 (not a toll-free call).

Partnership Magnetic Media Filing Requirements

Notice 97–77

PURPOSE

This notice provides guidance to partnerships having more than 100 partners regarding the requirement to file partnership tax returns on magnetic media under § 6011(e) of the Internal Revenue Code, as amended by § 1224 of the Taxpayer Relief Act of 1997 (Act), Pub. L. 105-34, 111 Stat. 788 (August 5, 1997).

BACKGROUND

Section 6011(e)(1) generally provides that the Secretary will prescribe regulations providing standards for determining which returns must be filed on magnetic media or in other machine-readable form.

Section 6011(e)(2) defines the requirements of the regulations, and provides that, in prescribing the regulations under § 6011(e)(1), the Secretary will not require any person to file returns on magnetic media unless such person is required to file at least 250 returns during the calendar year, and will take into account (among other relevant factors) the ability of the taxpayer to comply at reasonable cost with the requirements of such regulations.

Section 1224 of the Act amended § 6011(e)(2) to provide that the Secretary will require partnerships having more than 100 partners to file returns on magnetic media. Section 1226 of the Act provides that § 1224 is effective for tax years ending on or after December 31, 1997. However, the legislative history of the Act, as provided in H.R. Conf. Rep. No. 220, 105th Cong., 1st Sess. 675 (1997), indicates that § 1224 is effective for tax years beginning after December 31, 1997. The Tax Technical Corrections Act of 1997, which is currently pending in Congress, provides that the effective date in § 1226 of the Act is for partnership tax years beginning after December 31, 1997. H.R. 2645, 105th Cong., 1st Sess. § 11(c) (1997).

TAX YEARS BEGINNING AFTER DECEMBER 31, 1997

The Service intends to implement § 1224 of the Act by issuing regulations as required by § 6011(e). The regulations will address the mandatory magnetic media filing requirements for Form 1065, U.S. Partnership Return of Income, for Schedules K-1, Shareholder's Share of Income, Credits, Deductions, etc., and for all other related forms and schedules. These regulations, however, will only address the requirements for tax years beginning after December 31, 1997.

TAX YEARS BEGINNING BEFORE JANUARY 1, 1998

The Service will not require magnetic media filing of partnership tax returns for partnership tax years beginning before January 1, 1998. Therefore, a partnership with more than 100 partners will not be required to file its partnership tax return on magnetic media for a tax year ending December 31, 1997, and no penalties will be imposed on the partnership for not filing such partnership tax return on magnetic media.

DRAFTING INFORMATION

The principal author of this notice is Bridget E. Finkenaur of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this notice, contact Ms. Finkenaur at (202) 622-4940 (not a toll-free number).

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, § 6662.)

Rev. Proc. 97–56

SECTION 1. PURPOSE

.01 This revenue procedure updates Rev. Proc. 96-58, 1996–2 C.B. 390 and identifies circumstances under which the disclosure on a taxpayer's return of a position with respect to an item is adequate for the purpose of reducing the understatement of income tax under § 6662(d) of the Internal Revenue Code (relating to the substantial understatement aspect of the accuracy-related penalty), and for the purpose of avoiding the preparer penalty under § 6694(a) (relating to understatements due to unrealistic positions). This revenue procedure does not apply with respect to any other penalty provision (including the negligence or disregard provisions of the § 6662 accuracy-related penalty).

.02 This revenue procedure applies to any return filed on 1997 tax forms for a taxable year beginning in 1997, and to any return filed on 1997 tax forms in 1998 for short taxable years beginning in 1998.

SEC. 2. CHANGES FROM REV. PROC. 96-58

Editorial changes only have been made in this revenue procedure.

SEC. 3. BACKGROUND

.01 If § 6662 applies to any portion of an underpayment of tax required to be shown on a return, an amount equal to 20 percent of the portion of the underpayment to which the section applies is added to the tax. (The penalty rate is 40 percent in the case of certain gross valuation misstatements.) Under § 6662(b)(2), § 6662 applies to the portion of an underpayment that is attributable to a substantial understatement of income tax.

.02 Section 6662(d)(1) provides that there is a substantial understatement of income tax if the amount of the understatement exceeds the greater of 10 percent of the amount of tax required to be shown on the return for the taxable year or $5,000 ($10,000 in the case of a corporation other than an S corporation or a personal holding company). Section 6662(d)(2) defines an understatement as the excess of the amount of tax required to be shown on the return for the taxable year over the amount of the tax that is shown on the return reduced by any rebate (within the meaning of § 6211(b)(2)).

.03 In the case of an item not attributable to a tax shelter, § 6662(d)(2)(B)(ii) provides that the amount of the understatement is reduced by the portion of the

understatement attributable to any item with respect to which the relevant facts affecting the item's tax treatment are adequately disclosed on the return or on a statement attached to the return, and there is a reasonable basis for the tax treatment of such item by the taxpayer.

.04 In general, this revenue procedure provides guidance in determining when disclosure is adequate for purposes of § 6662(d). For purposes of this revenue procedure, the taxpayer must furnish all required information in accordance with the applicable forms and instructions, and the money amounts entered on these forms must be verifiable. Guidance under § 6662(d) for returns filed in 1995, 1996, and 1997 is provided in Rev. Proc. 94–74, 1994–2 C.B. 823; Rev. Proc. 95–55, 1995–2 C.B. 457; and Rev. Proc.96–58, 1996–2 C.B. 390, respectively.

SEC. 4. PROCEDURE

.01 Additional disclosure of facts relevant to, or positions taken with respect to, issues involving any of the items set forth below is unnecessary for purposes of reducing any understatement of income tax under § 6662(d) provided that the forms and attachments are completed in a clear manner and in accordance with their instructions. The money amounts entered on the forms must be verifiable, and the information on the return must be disclosed in the manner described below. For purposes of this revenue procedure, a number is verifiable if, on audit, the taxpayer can demonstrate the origin of the number (even if that number is not ultimately accepted by the Internal Revenue Service) and the taxpayer can show good faith in entering that number on the applicable form.

(1) Form 1040, Schedule A, Itemized Deductions:

(a) Medical and Dental Expenses: Complete lines 1 through 4, supplying all required information.

(b) Taxes: Complete lines 5 through 9, supplying all required information. Line 8 must list each type of tax and the amount paid.

(c) Interest Expense: Complete lines 10 through 14, supplying all required information. This section 4.01(1)(c) does not apply to (i) amounts disallowed under § 163(d) unless Form 4952, Investment Interest Expense Deduction, is completed, or (ii) amounts disallowed under § 265.

(d) Contributions: Complete lines 15 through 18, supplying all required information. Merely entering the amount of the donation on Schedule A, however, will not constitute adequate disclosure if the taxpayer receives a substantial benefit from the donation shown. If a contribution of property other than cash is made and the amount claimed as a deduction exceeds $500, a properly completed Form 8283, Noncash Charitable Contributions, must be attached to the return. This section 4.01(1)(d) will not apply to any contribution of $250 or more unless the contemporaneous written acknowledgement requirement of § 170(f)(8) is satisfied.

(e) Casualty and Theft Losses: Complete Form 4684, Casualties and Thefts, and attach to the return. Each item or article for which a casualty or theft loss is claimed must be listed on Form 4684.

(2) Certain Trade or Business Expenses (including, for purposes of this section 4.01(2), the following six expenses as they relate to the rental of property):

(a) Casualty and Theft Losses: The procedure outlined in section 4.01(1)(e) above must be followed.

(b) Legal Expenses: The amount claimed must be stated. This section 4.01(2)(b) does not apply, however, to amounts properly characterized as capital expenditures, personal expenses, or nondeductible lobbying or political expenditures, including amounts that are required to be (or that are) amortized over a period of years.

(c) Specific Bad Debt Charge-off: The amount written off must be stated.

(d) Reasonableness of Officers' Compensation: Form 1120, Schedule E, Compensation of Officers, must be completed when required by its instructions. The time devoted to business must be expressed as a percentage as opposed to "part" or "as needed." This section 4.01(2)(d) does not apply to "golden parachute" payments, as defined under § 280G. This section 4.01(2)(d) will not apply to the extent that remuneration paid or incurred exceeds the $1 million employee remuneration limitation, if applicable.

(e) Repair Expenses: The amount claimed must be stated. This section 4.01(2)(e) does not apply, however, to any repair expenses properly characterized as capital expenditures or personal expenses.

(f) Taxes (other than foreign taxes): The amount claimed must be stated.

(3) Form 1120, Schedule M–1, Reconciliation of Income (Loss) per Books With Income per Return, provided:

(a) The amount of the deviation from the financial books and records is not the result of a computation that includes the netting of items; and

(b) The information provided reasonably may be expected to apprise the Internal Revenue Service of the nature of the potential controversy concerning the tax treatment of the item.

(4) Foreign Tax Items:

(a) International Boycott Transactions: Transactions disclosed on Form 5713, International Boycott Report.

(b) Intercompany Transactions: Transactions and amounts shown on Schedule M (Form 5471), Transactions Between Controlled Foreign Corporation and Shareholders or Other Related Persons, lines 19 and 20, and Form 5472, Part IV, Monetary Transactions Between Reporting Corporations and Foreign Related Party, lines 7 and 18.

(5) Other:

(a) Moving Expenses: Complete Form 3903, Moving Expenses, or Form 3903-F, Foreign Moving Expenses, and attach to the return.

(b) Sale or Exchange of Your Main Home: Complete Form 2119, Sale of Your Home, and attach to the return.

(c) Employee Business Expenses: Complete Form 2106, Employee Business Expenses, or Form 2106–EZ, Unreimbursed Employee Business Expenses, and attach to the return. This section 4.01(5)(c) does not apply to club dues, or to travel expenses for any non-employee accompanying the taxpayer on a trip.

(d) Fuels Credit: Complete Form 4136, Credit for Federal Tax Paid on Fuels, and attach to the return.

(e) Investment Credit: Complete Form 3468, Investment Credit, and attach to the return.

SEC. 5. EFFECTIVE DATE

.01 This revenue procedure applies to any return filed on 1997 tax forms for a taxable year beginning in 1997, and to any return filed on 1997 tax forms in 1998 for short taxable years beginning in 1998.

SEC. 6. DRAFTING INFORMATION

The principal author of this revenue procedure is Marcia Rachy of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Rachy on (202) 622-6232 (not a toll-free call).

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26 CFR 601.602: Tax forms and instructions.
(Also Part I, §§ 1, 32, 63, 68, 132, 135, 151, 170, 213, 512, 513, 877, 4001, 4003, 6012, 6013, 6033, 6039F, 6334, 7430, 7702B; 1.1–1, 1.32–2, 1.63–1, 1.151–4, 1.170–1, 1.6012–1, 1.6013–1)

Rev. Proc. 97–57

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SECTION 1. PURPOSE

This revenue procedure sets forth inflation adjusted items for 1998.

SECTION 2. CHANGES MADE FROM PRECEDING YEAR

.01 In preceding years, this revenue procedure included a detailed description of each inflation adjusted item in former section 3, a technical explanation of the authority for each inflation adjustment in former section 4 and the inflation factors used to make the inflation adjustments in former section 5. To simplify this revenue procedure, section 3 has been revised, and sections 4 and 5 have been deleted.

.02 The limitations regarding the amount of eligible long-term care premiums includible in the term "medical care" under § 213(d)(10) of the Internal Revenue Code, as enacted by section 322 of the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104–191, 110 Stat. 1936 (1996), are adjusted for inflation for tax years beginning in 1998 (section 3.09).

.03 The value of property exempt from levy under § 6334(a)(2) (fuel, certain household items, arms for personal use,

livestock, and poultry) and under § 6334(a)(3) (books and tools of a trade, business, or profession), as amended by section 502 of the Taxpayer Bill of Rights 2, Pub. L. No. 104–168, 110 Stat. 1452 (1996), is adjusted for inflation for calendar year 1998 (section 3.16).

.04 The stated dollar amount of the per diem limitation under § 7702B(d)(4), as enacted by section 321 of the Health Insurance Portability and Accountability Act of 1996, Pub. L. No. 104–191, 110 Stat. 1936 (1996), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is adjusted for inflation for calendar year 1998 (section 3.18).

SECTION 3. 1998 ADJUSTED ITEMS

.01 *Tax Rate Tables*. For tax years beginning in 1998, the tax rate tables under § 1 are as follows:

TABLE 1–Section 1(a).—MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES

If Taxable Income Is:	The Tax Is:
Not Over $42,350	15% of the taxable income
Over $42,350 but not over $102,300	$6,352.50 plus 28% of the excess over $42,350
Over $102,300 but not over $155,950	$23,138.50 plus 31% of the excess over $102,300
Over $155,950 but not over $278,450	$39,770 plus 36% of the excess over $155,950
Over $278,450	$83,870 plus 39.6% of the excess over $278,450

TABLE 2 - Section 1(b).—HEADS OF HOUSEHOLDS

If Taxable Income Is:	The Tax Is:
Not Over $33,950	15% of the taxable income
Over $33,950 but not over $87,700	$5,092.50 plus 28% of the excess over $33,950
Over $87,700 but not over $142,000	$20,142.50 plus 31% of the excess over $87,700
Over $142,000 but not over $278,450	$36,975.50 plus 36% of the excess over $142,000
Over $278,450	$86,097.50 plus 39.6% of the excess over $278,450

TABLE 3–Section 1(c).—UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS)

If Taxable Income Is:	The Tax Is:
Not Over $25,350	15% of the taxable income
Over $25,350 but not over $61,400	$3,802.50 plus 28% of the excess over $25,350
Over $61,400 but not over $128,100	$13,896.50 plus 31% of the excess over $61,400
Over $128,100 but not over $278,450	$34,573.50 plus 36% of the excess over $128,100
Over $278,450	$88,699.50 plus 39.6% of the excess over $278,450

TABLE 4–Section 1(d).—MARRIED INDIVIDUALS FILING SEPARATE RETURNS

If Taxable Income Is:	The Tax Is:
Not Over $21,175	15% of the taxable income
Over $21,175 but not over $51,150	$3,176.25 plus 28% of the excess over $21,175
Over $51,150 but not over $77,975	$11,569.25 plus 31% of the excess over $51,150
Over $77,975 but not over $139,225	$19,885 plus 36% of the excess over $77,975
Over $139,225	$41,935 plus 39.6% of the excess over $139,225

TABLE 5–Section 1(e).—ESTATES AND TRUSTS

If Taxable Income Is:	The Tax Is:
Not Over $1,700	15% of the taxable income
Over $1,700 but not over $4,000	$255 plus 28% of the excess over $1,700
Over $4,000 but not over $6,100	$899 plus 31% of the excess over $4,000
Over $6,100 but not over $8,350	$1,550 plus 36% of the excess over $6,100
Over $8,350	$2,360 plus 39.6% of the excess over $8,350

.02 *Unearned Income of Minor Children Taxed as if Parent's Income (the "Kiddie Tax").* For tax years beginning in 1998, the amount in § 1(g)(4)(A)(ii)(I), which is used to reduce the net unearned income reported on the child's return that is subject to the "kiddie tax," is $700. (This amount is the same as the $700 standard deduction amount provided in section 3.04(2) of this revenue procedure.) In the alternative, the same $700 amount is used for purposes of § 1(g)(7) (that is, determining whether a parent may elect to include a child's gross income in the parent's gross income and for calculating the "kiddie tax").

.03 *Earned Income Tax Credit.*

(1) *In general.* For tax years beginning in 1998, the following amounts are used to determine the earned income tax credit under § 32(b). The "earned income amount" is the amount of earned income at or above which the maximum amount of the earned income tax credit is allowed. The "threshold phaseout amount" is the amount of modified adjusted gross income (or, if greater, earned income) above which the maximum amount of the credit begins to phase out. The "completed phaseout amount" is the amount of modified adjusted gross income (or if greater, earned income) at or above which no credit is allowed.

Number of Children	*Maximum Amount of the Credit*	*Earned Income Amount*	*Threshold Phaseout Amount*	*Completed Phaseout Amount*
1	$2,271	$6,680	$12,260	$26,473
2 or more	$3,756	$9,390	$12,260	$30,095
None	$ 341	$4,460	$ 5,570	$10,030

The Internal Revenue Service, in the instructions for the Form 1040 series, provides tables showing the amount of the earned income tax credit for each type of taxpayer.

(2) *Excessive investment income.* For tax years beginning in 1998, the earned income tax credit is denied under § 32(i) if the aggregate amount of certain investment income exceeds $2,300.

.04 *Standard Deduction.*

(1) *In general.* For tax years beginning in 1998, the standard deduction amounts under § 63(c)(2) are as follows:

Filing Status	*Standard Deduction*
MARRIED INDIVIDUALS FILING JOINT RETURNS AND SURVIVING SPOUSES (§ 1(a))	$7,100
HEADS OF HOUSEHOLDS (§ 1(b))	$6,250
UNMARRIED INDIVIDUALS (OTHER THAN SURVIVING SPOUSES AND HEADS OF HOUSEHOLDS) (§ 1(c))	$4,250
MARRIED INDIVIDUALS FILING SEPARATE RETURNS (§ 1(d))	$3,550

(2) *Dependent.* For tax years beginning in 1998, the standard deduction amount under § 63(c)(5) for an individual who may be claimed as a dependent by

another taxpayer may not exceed the greater of $700, or the sum of $250 and the individual's earned income.

(3) *Aged and blind.* For tax years beginning in 1998, the additional standard deduction amounts under § 63(f) for the aged and for the blind are $850 for each. These amounts are increased to $1,050 if the individual is also unmarried and not a surviving spouse.

.05 *Overall Limitation on Itemized Deductions*. For tax years beginning in 1998, the "applicable amount" of adjusted gross income under § 68(b), above which the amount of otherwise allowable itemized deductions is reduced under § 68, is $124,500 (or $62,250 for a separate return filed by a married individual).

.06 Q*ualified Transportation Fringe*. For tax years beginning in 1998, the monthly limitation under § 132(f)(2)(A), regarding the aggregate fringe benefit exclusion amount for transportation in a commuter highway vehicle and any transit pass, is $65. The monthly limitation under § 132(f)(2)(B) regarding the fringe benefit exclusion amount for qualified parking is $175.

.07 *Income from United States Savings Bonds for Taxpayers Who Pay Qualified Higher Education Expenses*. For tax years beginning in 1998, the exclusion under § 135, regarding income from United States savings bonds for taxpayers who pay qualified higher education expenses, begins to phase out for modified adjusted gross income above $78,350 for joint returns and $52,250 for other returns. This exclusion completely phases out for modified adjusted gross income of $108,350 or more for joint returns and $67,250 or more for other returns.

.08 *Personal Exemption.*

(1) *Exemption amount.* For tax years beginning in 1998, the personal exemption amount under § 151(d) is $2,700.

(2) *Phaseout.* For tax years beginning in 1998, the personal exemption amount begins to phase out at, and is completely phased out after, the following adjusted gross income amounts:

Filing Status	*Threshold Phaseout Amount*	*Completed Phaseout Amount After*
Code § 1(a)	$186,800	$309,300
Code § 1(b	$155,650	$278,150
Code § 1(c)	$124,500	$247,000
Code § 1(d)	$ 93,400	$154,650

.09 Eligible Long-Term Care Premiums. For tax years beginning in 1998, the limitations under § 213(d), regarding eligible long- term care premiums includible in the term "medical care," are as follows:

Attained age before the close of the taxable year:	
40 or less	$ 210
More than 40 but not more than 50	$ 380
More than 50 but not more than 60	$ 770
More than 60 but not more than 70	$2,050
More than 70	$2,570

.10 *Treatment of Dues Paid to Agricultural or Horticultural Organizations*. For tax years beginning in 1998, the limitation under § 512(d)(1), regarding the exemption of annual dues required to be paid by a member to an agricultural or horticultural organization, is $109.

.11 *Insubstantial Benefit Limitations for Contributions Associated with Charitable Fund-Raising Campaigns*.

(1) *Low cost article.* For tax years beginning in 1998, the unrelated business income of certain exempt organizations under § 513(h)(2) does not include a "low cost article" of $7.10 or less.

(2) *Other insubstantial benefits*. For tax years beginning in 1998, the $5, $25, and $50 guidelines in section 3 of Rev. Proc. 90-12, 1990-1 C.B. 471 (as amplified and modified), for disregarding the value of insubstantial benefits received by a donor in return for a fully deductible charitable contribution under § 170, are $7.10, $35.50, and $71, respectively.

12 *Expatriation to Avoid Tax*. For calendar year 1998, the thresholds used under § 877(a)(2), regarding whether an individual's loss of United States citizenship had the avoidance of United States taxes as one of its principal purposes, are more than $109,000 for "average annual net income tax" and $543,000 or more for "net worth."

.13 *Luxury Automobile Excise Tax*. For calendar year 1998, the excise tax under §§ 4001 and 4003 is imposed on the first retail sale of a passenger vehicle (including certain parts or accessories installed within six months of the date after the vehicle was first placed in service), to the extent the price exceeds $36,000.

.14 *Reporting Exception for Certain Exempt Organizations with Nondeductible Lobbying Expenditures*. For tax years beginning in 1998, the annual per person, family, or entity dues limitation to qualify for the reporting exception under § 6033(e)(3) (and section 4.02 of Rev. Proc. 95–35, 1995–2 C.B. 391), regarding certain exempt organizations with nondeductible lobbying expenditures, is $55 or less.

.15 *Notice of Large Gifts Received from Foreign Persons*. For tax years beginning in 1998, recipients of gifts from certain foreign persons may have to report these gifts under § 6039F if the aggregate value of gifts received in a taxable year exceeds $10,557.

.16 *Property Exempt from Levy*. For calendar year 1998, the value of property exempt from levy under § 6334(a)(2) (fuel, provisions, furniture, and other household personal effects, as well as arms for personal use, livestock, and poultry) may not exceed $2,570. The value of property exempt from levy under § 6334(a)(3) (books and tools necessary for the trade, business, or profession of the taxpayer) may not exceed $1,280.

.17 *Attorney Fee Awards*. For calendar year 1998, the attorney fee award limitation under § 7430(c)(1)(B)(iii) is $120 per hour.

.18 *Periodic Payments Received under Qualified Long-Term Care Insurance Contracts or under Certain Life Insurance Contract*s. For calendar year 1998, the stated dollar amount of the per diem limitation under § 7702B(d)(4), regarding periodic payments received under a qualified long-term care insurance contract or periodic payments received under a life insurance contract that are treated as paid by reason of the death of a chronically ill individual, is $180.

SECTION 4. EFFECTIVE DATE

.01 *General Rule*. Except as provided in section 4.02, this revenue procedure applies to tax years beginning in 1998.

.02 *Calendar Year Rule*. This revenue procedure applies to transactions or events occurring in calendar year 1998 for purposes of section 3.12 (the expatriation tax), section 3.13 (the excise tax on luxury automobiles), section 3.16 (the value of certain property exempt from levy), section 3.17 (the hourly limit on attorney fee awards), and section 3.18 (the per diem limitation for periodic payments re-

ceived under qualified long-term care insurance contracts).

SECTION 5. DRAFTING INFORMATION

The principal author of this revenue procedure is John Moran of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Moran on (202) 622-4940 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, sections 62, 162, 274, 1016; 1.62–2, 1.162–17, 1.274–5T, 1.274(d)–1, 1.1016–3.)

Rev. Proc. 97–58

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 96–63, 1996–2 C.B. 420, by providing optional standard mileage rates for employees, self-employed individuals, or other taxpayers to use in computing the deductible costs paid or incurred on or after January 1, 1998, of operating an automobile for business, charitable, medical, or moving expense purposes. This revenue procedure also provides rules under which the amount of ordinary and necessary expenses of local travel or transportation away from home that are paid or incurred by an employee will be deemed substantiated under § 1.274–5T of the temporary Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a mileage allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. Use of a method of substantiation described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation.

SECTION 2. SUMMARY OF STANDARD MILEAGE RATES

Business (section 5 below)	32.5 cents per mile
Charitable (section 7 below)	14 cents per mile
Medical and Moving (section 7 below)	10 cents per mile

SECTION 3. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating an automobile to the extent that it is used in a trade or business. However, under § 262, no portion of the cost of operating an automobile that is attributable to personal use is deductible.

.02 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 with respect to any listed property (as defined in § 280F(d)(4) to include passenger automobiles and any other property used as a means of transportation) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.03 Section 1.274(d)–1, in part, grants the Commissioner the authority to prescribe rules relating to mileage allowances for ordinary and necessary expenses of local travel and transportation away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such allowances, if in accordance with reasonable business practice, will be regarded as (1) equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel and transportation expenses for purposes of § 1.274–5T(c), and (2) satisfying the requirements of an adequate accounting to the employer of the amount of such expenses for purposes of § 1.274–5T(f).

.04 Section 62(a)(2)(A) allows an employee, in determining adjusted gross income, a deduction for the expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.05 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)-(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement. Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.06 Under § 1.62–2(c)(1), a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2-(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274(d)–1 will be treated as substantiation of the amount of such expenses for purposes of § 1.62-2. Under § 1.62–2-(f)(2), the Commissioner may prescribe rules under which an arrangement providing mileage allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to miles of travel not substantiated.

.07 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a mileage allowance under an arrangement that meets the requirements of § 1.62–-2(c)(1), the portion, if any, of the allowance that relates to miles of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under §§ 274(d) and 1.274(d)–1, and that the employee is not required to return, is subject to with-

holding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401-(a)–4. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this excess portion.

.08 Under § 1.62-2(h)(2)(i)(B)(*4*), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on mileage allowances.

.09 Significant changes to this revenue procedure include:

(1) the increase in the charitable standard mileage rate (sections 2 and 7.01);

(2) the deletion of the rural mail carrier special mileage rate (in sections 2 and 6 of Rev. Proc. 96–63) and the addition of section 5.06(4) because of amendments made to § 162(o) by § 1203 of the Taxpayer Relief Act of 1997, Pub. L. No. 105– 34, 111 Stat. 788 (August 5, 1997); and

(3) the extension of the rules for using the business standard mileage rate or a fixed and variable rate (FAVR) allowance to apply to leased automobiles (sections 4, 5, 8, and 9).

SECTION 4. DEFINITIONS

.01 *Standard mileage rate*. The term "standard mileage rate" means the applicable amount provided by the Service for optional use by employees or self-employed individuals in computing the deductible costs of operating automobiles (including vans, pickups, or panel trucks) owned or leased for business purposes, or by taxpayers in computing the deductible costs of operating automobiles for charitable, medical, or moving expense purposes.

.02 *Transportation expenses*. The term "transportation expenses" means the expenses of operating an automobile for local travel or transportation away from home.

.03 *Mileage allowance*. The term "mileage allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62-2(c)(1) and that is

(1) paid with respect to the ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for transportation expenses in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at the applicable standard mileage rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.04 *Flat rate or stated schedule*. A mileage allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 4.03 of this revenue procedure. Such allowance may be paid periodically at a fixed rate, at a cents-per-mile rate, at a variable rate based on a stated schedule, at a rate that combines any of these rates, or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, a periodic payment at a fixed rate to cover the fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving an automobile in connection with the performance of services as an employee of the employer, coupled with a periodic payment at a cents-per-mile rate to cover the operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of using an automobile for such purposes, is an allowance paid at a flat rate or stated schedule. Likewise, a periodic payment at a variable rate based on a stated schedule for different locales to cover the costs of driving an automobile in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

SECTION 5. BUSINESS STANDARD MILEAGE RATE

.01 *In general*. The standard mileage rate for transportation expenses paid or incurred on or after January 1, 1998, is 32.5 cents per mile for all miles of use for business purposes. This business standard mileage rate will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.02 *Use of the business standard mileage rate*. A taxpayer may use the business standard mileage rate with respect to an automobile that is either owned or leased by the taxpayer. A taxpayer generally may deduct an amount equal to either the business standard mileage rate times the number of business miles traveled or the actual costs (both operating and fixed) paid or incurred by the taxpayer that are allocable to traveling those business miles.

.03 *Business standard mileage rate in lieu of operating and fixed costs.* A deduction using the standard mileage rate for business miles is computed on a yearly basis and is in lieu of all operating and fixed costs of the automobile allocable to business purposes (except as provided in section 9.06 of this revenue procedure). Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and license and registration fees are included in operating and fixed costs for this purpose.

.04 *Parking fees, tolls, interest, and taxes*. Parking fees and tolls attributable to use of the automobile for business purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local taxes (other than those included in the cost of gasoline) may be deducted as separate items, but only to the extent that the interest or taxes are allowable deductions under § 163 or 164 respectively. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable. However, § 163(h)(2)(A) expressly provides that interest is nondeductible personal interest when it is paid or accrued on indebtedness properly allocable to the trade or business of performing services as an employee. Section 164 also expressly provides that state and local taxes that are paid or accrued by a taxpayer in connection with an acquisition or disposition of property will be treated as part of the cost of the acquired property or as a reduction in the amount realized on the disposition of such property.

.05 *Depreciation.* For owned automobiles placed in service for business purposes, and for which the business standard mileage rate has been used for any year, depreciation will be considered to

have been allowed at the rate of 12 cents a mile for 1994, 1995, 1996, 1997, and 1998, for those years in which the business standard mileage rate was used. If actual costs were used for one or more of those years, the rates above will not apply to any year in which such costs were used. The depreciation described above will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016.

.06 *Limitations.*

(1) The business standard mileage rate may not be used to compute the deductible expenses of (a) automobiles used for hire, such as taxicabs, or (b) two or more automobiles used simultaneously (such as in fleet operations).

(2) The business standard mileage rate may not be used to compute the deductible businsess expenses of an automobile leased by a taxpayer unless the taxpayer uses either the business standard mileage rate or a FAVR allowance (as provided in section 8 of this revenue procedure) to compute the deductible business expenses of the automobile for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(3) The business standard mileage rate may not be used to compute the deductible expenses of an automobile for which the taxpayer has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. By using the business standard mileage rate, the taxpayer has elected to exclude the automobile (if owned) from MACRS pursuant to § 168(f)(1). If, after using the business standard mileage rate, the taxpayer uses actual costs, the taxpayer must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(4) The business standard mileage rate and this revenue procedure may not be used to compute the amount of the deductible automobile expenses of an employee of the United States Postal Service incurred in performing services involving the collection and delivery of mail on a rural route if the employee receives qualified reimbursements (as defined in § 162(o)) for such expenses. See § 162(o), as amended by § 1203 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788 (August 5, 1997) for the rules that apply to these qualified reimbursements.

SECTION 6. RESERVED

SECTION 7. CHARITABLE, MEDICAL, AND MOVING STANDARD MILEAGE RATE

.01 *Charitable.* Section 170(i), as amended by § 973 of the Taxpayer Relief Act of 1997, provides a standard mileage rate of 14 cents per mile for purposes of computing the charitable deduction for use of an automobile in connection with rendering gratuitous services to a charitable organization under § 170, for taxable years beginning after December 31, 1997.

.02 *Medical and moving.* The standard mileage rate is 10 cents per mile for use of an automobile (a) to obtain medical care described in § 213, or (b) as part of a move for which the expenses are deductible under § 217. The standard mileage rates for medical and moving transportation expenses will be adjusted annually (to the extent warranted) by the Service, and any such adjustment will be applied prospectively.

.03 *Charitable, medical, or moving expense standard mileage rate in lieu of operating expenses.* A deduction computed using the applicable standard mileage rate for charitable, medical, or moving expense miles is in lieu of all operating expenses (including gasoline and oil) of the automobile allocable to such purposes. Costs for such items as depreciation (or lease payments), maintenance and repairs, tires, insurance, and license and registration fees are not deductible, and are not included in such standard mileage rates.

.04 *Parking fees, tolls, interest, and taxes.* Parking fees and tolls attributable to the use of the automobile for charitable, medical, or moving expense purposes may be deducted as separate items. Likewise, interest relating to the purchase of the automobile as well as state and local taxes (other than those included in the cost of gasoline) may be deducted as separate items, but only to the extent that the interest and taxes are allowable deductions under § 163 or 164, respectively.

SECTION 8. FIXED AND VARIABLE RATE ALLOWANCE

.01 *In general.*

(1) The ordinary and necessary expenses paid or incurred by an employee in driving an automobile owned or leased by the employee in connection with the performance of services as an employee of the employer will be deemed substantiated (in an amount determined under section 9 of this revenue procedure) when a payor reimburses such expenses with a mileage allowance using a flat rate or stated schedule that combines periodic fixed and variable rate payments that meet all the requirements of section 8 of this revenue procedure (a FAVR allowance).

(2) The amount of a FAVR allowance must be based on data that (a) is derived from the base locality, (b) reflects retail prices paid by consumers, and (c) is reasonable and statistically defensible in approximating the actual expenses employees receiving the allowance would incur as owners of the standard automobile.

.02 *Definitions.*

(1) *FAVR allowance.* A FAVR allowance includes periodic fixed payments and periodic variable payments. A payor may maintain more than one FAVR allowance. A FAVR allowance that uses the same payor, standard automobile (or an automobile of the same make and model that is comparably equipped), retention period, and business use percentage is considered one FAVR allowance, even though other features of the allowance may vary. A FAVR allowance also includes any optional high mileage payments; however, such optional high mileage payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes when paid. See section 9.05 of this revenue procedure. An optional high mileage payment covers the additional depreciation for a standard automobile attributable to business miles driven and substantiated by the employee for a calen-

dar year in excess of the annual business mileage for that year. If an employee is covered by the FAVR allowance for less than the entire calendar year, the annual business mileage may be prorated on a monthly basis for purposes of the preceding sentence.

(2) *Periodic fixed payment*. A periodic fixed payment covers the projected fixed costs (including depreciation (or lease payments), insurance, registration and license fees, and personal property taxes) of driving the standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. A periodic fixed payment may be computed by (a) dividing the total projected fixed costs of the standard automobile for all years of the retention period, determined at the beginning of the retention period, by the number of periodic fixed payments in the retention period, and (b) multiplying the resulting amount by the business use percentage.

(3) *Periodic variable payment*. A periodic variable payment covers the projected operating costs (including gasoline and all taxes thereon, oil, tires, and routine maintenance and repairs) of driving a standard automobile in connection with the performance of services as an employee of the employer in a base locality, and must be paid at least quarterly. The rate of a periodic variable payment for a computation period may be computed by dividing the total projected operating costs for the standard automobile for the computation period, determined at the beginning of the computation period, by the computation period mileage. A computation period can be any period of a year or less. Computation period mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a computation period and equals the retention mileage divided by the number of computation periods in the retention period. For each business mile substantiated by the employee for the computation period, the periodic variable payment must be paid at a rate that does not exceed the rate for that computation period.

(4) *Base locality*. A base locality is the particular geographic locality or region of the United States in which the costs of driving an automobile in connection with the performance of services as an employee of the employer are generally paid or incurred by the employee. Thus, for purposes of determining the amount of fixed costs, the base locality is generally the geographic locality or region in which the employee resides. For purposes of determining the amount of operating costs, the base locality is generally the geographic locality or region in which the employee drives the automobile in connection with the performance of services as an employee of the employer.

(5) *Standard automobile*. A standard automobile is the automobile selected by the payor on which a specific FAVR allowance is based.

(6) *Standard automobile cost*. The standard automobile cost for a calendar year may not exceed 95 percent of the sum of (a) the retail dealer invoice cost of the standard automobile in the base locality, and (b) state and local sales or use taxes applicable on the purchase of such an automobile. Further, the standard automobile cost may not exceed $27,100.

(7) *Annual mileage*. Annual mileage is the total mileage (business and personal) a payor reasonably projects a standard automobile will be driven during a calendar year. Annual mileage equals the annual business mileage divided by the business use percentage.

(8) *Annual business mileage*. Annual business mileage is the mileage a payor reasonably projects a standard automobile will be driven by an employee in connection with the performance of services as an employee of the employer during the calendar year, but may not be less than 6,250 miles for a calendar year. Annual business mileage equals the annual mileage multiplied by the business use percentage.

(9) *Business use percentage*. A business use percentage is determined by dividing the annual business mileage by the annual mileage. The business use percentage may not exceed 75 percent. In lieu of demonstrating the reasonableness of the business use percentage based on records of total mileage and business mileage driven by the employees annually, a payor may use a business use percentage that is less than or equal to the following percentages for a FAVR allowance that is paid for the following annual business mileage:

Annual business mileage	Business use percentage
6,250 or more but less than 10,000	45 percent
10,000 or more but less than 15,000	55 percent
15,000 or more but less than 20,000	65 percent
20,000 or more	75 percent

(10) *Retention period*. A retention period is the period in calendar years selected by the payor during which the payor expects an employee to drive a standard automobile in connection with the performance of services as an employee of the employer before the automobile is replaced. Such period may not be less than two calendar years.

(11) *Retention mileage*. Retention mileage is the annual mileage multiplied by the number of calendar years in the retention period.

(12) *Residual value*. The residual value of a standard automobile is the projected amount for which it could be sold at the end of the retention period after being driven the retention mileage. The Service will accept the following safe harbor residual values for a standard automobile computed as a percentage of the standard automobile cost:

Retention period	Residual value
2-year	70 percent
3-year	60 percent
4-year	50 percent

.03 *FAVR allowance in lieu of operating and fixed costs.*

(1) A reimbursement computed using a FAVR allowance is in lieu of the employee's deduction of all the operating and fixed costs paid or incurred by an employee in driving the automobile in connection with the performance of services as an employee of the employer, except as provided in section 9.06 of this revenue procedure. Such items as depreciation (or lease payments), maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, license and registration fees, and personal property taxes are included in operating and fixed costs for this purpose.

(2) Parking fees and tolls attributable to an employee driving the standard automo-

bile in connection with the performance of services as an employee of the employer are not included in fixed and operating costs and may be deducted as separate items. Similarly, interest relating to the purchase of the standard automobile may be deducted as a separate item, but only to the extent that the interest is an allowable deduction under § 163.

.04 *Depreciation.*

(1) A FAVR allowance may not be paid with respect to an automobile for which the employee has (a) claimed depreciation using a method other than straight-line for its estimated useful life, (b) claimed a § 179 deduction, or (c) used the Accelerated Cost Recovery System (ACRS) under former § 168 or the Modified Accelerated Cost Recovery System (MACRS) under current § 168. If an employee uses actual costs for an owned automobile that has been covered by a FAVR allowance, the employee must use straight-line depreciation for the automobile's remaining estimated useful life (subject to the applicable depreciation deduction limitations under § 280F).

(2) The total amount of the depreciation component for the retention period taken into account in computing the periodic fixed payments for that retention period may not exceed the excess of the standard automobile cost over the residual value of the standard automobile. In addition, the total amount of such depreciation component may not exceed the sum of the annual § 280F limitations on depreciation (in effect at the beginning of the retention period) that apply to the standard automobile during the retention period.

(3) The depreciation included in each periodic fixed payment portion of a FAVR allowance paid with respect to an automobile will reduce the basis of the automobile (but not below zero) in determining adjusted basis as required by § 1016. See section 8.07(2) of this revenue procedure for the requirement that the employer report the depreciation component of a periodic fixed payment to the employee.

.05 *FAVR allowance limitations.*

(1) A FAVR allowance may be paid only to an employee who substantiates to the payor for a calendar year at least 5,000 miles driven in connection with the performance of services as an employee of the employer or, if greater, 80 percent of the annual business mileage of that FAVR allowance. If the employee is covered by the FAVR allowance for less than the entire calendar year, these limits may be prorated on a monthly basis.

(2) A FAVR allowance may not be paid to a control employee (as defined in § 1.61–21(f)(5) and (6), excluding the $100,000 limitation in paragraph (f)(5)(iii)).

(3) At no time during a calendar year may a majority of the employees covered by a FAVR allowance be management employees.

(4) At all times during a calendar year at least 10 employees of an employer must be covered by one or more FAVR allowances.

(5) A FAVR allowance may be paid only with respect to an automobile (a) owned or leased by the employee receiving the payment, (b) the cost of which, when new, is at least 90 percent of the standard automobile cost taken into account for purposes of determining the FAVR allowance for the first calendar year the employee receives the allowance with respect to that automobile, and (c) the model year of which does not differ from the current calendar year by more than the number of years in the retention period.

(6) A FAVR allowance may not be paid with respect to an automobile leased by an employee for which the employee has used actual expenses to compute the deductible business expenses of the automobile for any year during the entire lease period. For a lease commencing on or before December 31, 1997, the "entire lease period" means the portion of the lease period (including renewals) remaining after that date.

(7) The insurance cost component of a FAVR allowance must be based on the rates charged in the base locality for insurance coverage on the standard automobile during the current calendar year without taking into account such rate-increasing factors as poor driving records or young drivers.

(8) A FAVR allowance may be paid only to an employee whose insurance coverage limits on the automobile with respect to which the FAVR allowance is paid are at least equal to the insurance coverage limits used to compute the periodic fixed payment under that FAVR allowance.

.06 *Employee reporting.* Within 30 days after an employee's automobile is initially covered by a FAVR allowance, or is again covered by a FAVR allowance if such coverage has lapsed, the employee by written declaration must provide the payor with the following information: (a) the make, model, and year of the employee's automobile, (b) written proof of the insurance coverage limits on the automobile, (c) the odometer reading of the automobile, (d) if owned, the purchase price of the automobile or, if leased, the price at which the automobile is ordinarily sold by retailers (the gross capitalized cost of the automobile), and (e) if owned, whether the employee has claimed depreciation with respect to the automobile using any of the depreciation methods prohibited by section 8.04(1) of this revenue procedure or, if leased, whether the employee has computed deductible business expenses with respect to the automobile using actual expenses. The information described in (a), (b), and (c) of the preceding sentence also must be supplied by the employee to the payor within 30 days after the beginning of each calendar year that the employee's automobile is covered by a FAVR allowance.

.07 *Payor recordkeeping and reporting.*

(1) The payor or its agent must maintain written records setting forth (a) the statistical data and projections on which the FAVR allowance payments are based, and (b) the information provided by the employees pursuant to section 8.06 of this revenue procedure.

(2) Within 30 days of the end of each calendar year, the employer must provide each employee covered by a FAVR allowance during that year with a statement that, for automobile owners, lists the amount of depreciation included in each periodic fixed payment portion of the FAVR allowance paid during that calendar year and explains that by receiving a FAVR allowance the employee has elected to exclude the automobile from MACRS pursuant to § 168(f)(1). For automobile lessees, the statement must explain that by receiving the FAVR allowance the employee may not compute the deductible business expenses of the automobile using actual expenses for the entire lease period (including renewals). For a lease commencing on or before December 31, 1997, the "entire lease pe-

riod" means the portion of the lease period (including renewals) remaining after that date.

.08 *Failure to meet section 8 requirements.* If an employee receives a mileage allowance that fails to meet one or more of the requirements of section 8 of this revenue procedure, the employee may not be treated as covered by any FAVR allowance of the payor during the period of such failure. Nevertheless, the expenses to which that mileage allowance relates may be deemed substantiated using the method described in sections 5, 9.01(1), and 9.02 of this revenue procedure to the extent the requirements of those sections are met.

SECTION 9. APPLICATION

.01 If a payor pays a mileage allowance in lieu of reimbursing actual transportation expenses incurred or to be incurred by an employee, the amount of the expenses that is deemed substantiated to the payor is either:

(1) for any mileage allowance other than a FAVR allowance, the lesser of the amount paid under the mileage allowance or the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee; or

(2) for a FAVR allowance, the amount paid under the FAVR allowance less the sum of (a) any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return to the payor although required to do so, (b) any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return to the payor although required to do so, and (c) any optional high mileage payments.

.02 If the amount of transportation expenses is deemed substantiated under the rules provided in section 9.01 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place (or use), and business purpose of the transportation expenses in accordance with paragraphs (b)(2) (travel away from home), (b)(6) (listed property, which includes passenger automobiles and any other property used as a means of transportation), and (c) of § 1.274–5T, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5T(f), as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5T(c). See § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.03 An arrangement providing mileage allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses as follows:

(1) For a mileage allowance other than a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to miles of travel not substantiated by the employee, even though the arrangement does not require the employee to return the portion of such an allowance that relates to the miles of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance mileage allowance of $70 based on an anticipated 200 business miles at 35 cents per mile (at a time when the applicable business standard mileage rate is 32.5 cents per mile), and the employee substantiates 120 business miles. The requirement to return excess amounts will be treated as satisfied if the employee is required to return the portion of the allowance that relates to the 80 unsubstantiated business miles ($28) even though the employee is not required to return the portion of the allowance ($3) that exceeds the amount of the employee's expenses deemed substantiated under section 9.01 of this revenue procedure ($39) for the 120 substantiated business miles. However, the $3 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 9.05.

(2) For a FAVR allowance, the requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)), (a) the portion (if any) of the periodic variable payment received that relates to miles in excess of the business miles substantiated by the employee, and (b) the portion (if any) of a periodic fixed payment that relates to a period during which the employee was not covered by the FAVR allowance.

.04 An employee is not required to include in gross income the portion of a mileage allowance received from a payor that is less than or equal to the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02. See § 1.274–5T(f)-(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W-2, and is exempt from the withholding and payment of employment taxes. See §§ 1.62–2(c)(2) and (c)(4).

.05 An employee is required to include in gross income only the portion of a mileage allowance received from a payor that exceeds the amount deemed substantiated under section 9.01 of this revenue procedure, provided the employee substantiates in accordance with section 9.02 of this revenue procedure. See § 1.274–5T(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See §§ 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.06

(1) Except as otherwise provided in section 9.06(2) of this revenue procedure with respect to leased automobiles, if the amount of the expenses deemed substantiated under the rules provided in section 9.01 of this revenue procedure is less than the amount of the employee's business transportation expenses, the employee may claim an itemized deduction for the amount by which the business transportation expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business transportation expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the mileage allowance received from the payor, and includes in gross income the portion (if any) of the mileage allowance

received from the payor that exceeds the amount deemed substantiated. See § 1.274–5T(f)(2)(iii). However, for purposes of claiming this itemized deduction, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the applicable standard mileage rate multiplied by the number of business miles substantiated by the employee minus the amount deemed substantiated under section 9.01 of this revenue procedure. The itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

(2) An employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(1) of this revenue procedure (relating to an allowance other than a FAVR allowance) may not claim a deduction based on actual expenses unless the employee does so consistently beginning with the first business use of the automobile after December 31, 1997. However, an employee whose business transportation expenses with respect to a leased automobile are deemed substantiated under section 9.01(2) of this revenue procedure (relating to a FAVR allowance) may not claim a deduction based on actual expenses.

.07 An employee may deduct an amount computed pursuant to section 5.01 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.08 A self-employed individual may deduct an amount computed pursuant to section 5.01 of this revenue procedure in determining adjusted gross income under § 62(a)(1).

.09 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W–2, and are subject to withholding and payment of employment taxes. See §§ 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 10. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a mileage allowance (other than a FAVR allowance), if any, that relates to the miles of business travel substantiated and that exceeds the amount deemed substantiated for those miles under section 9.01(1) of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62–2(h)(2)(i)(B).

(1) In the case of a mileage allowance paid as a reimbursement, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the business miles substantiated. See § 1.62–2(h)(2)(i)(B)(*2*).

(2) In the case of a mileage allowance paid as an advance, the excess described in section 10.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the business miles with respect to which the advance was paid are substantiated. See § 1.62–2(h)(2)-(i)(B)(*3*). If some or all of the business miles with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those miles within a reasonable period of time, the portion of the allowance that relates to those miles is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)(2)(i)(A).

(3) In the case of a mileage allowance that is not computed on the basis of a fixed amount per mile of travel (e.g., a mileage allowance that combines periodic fixed and variable rate payments, but that does not satisfy the requirements of section 8 of this revenue procedure), the payor must compute periodically (no less frequently than quarterly) the amount, if any, that exceeds the amount deemed substantiated under section 9.01(1) of this revenue procedure by comparing the total mileage allowance paid for the period to the applicable standard mileage rate in section 5.01 of this revenue procedure multiplied by the number of business miles substantiated by the employee for the period. Any excess is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62–2(h)(2)(i)(B)(*4*).

(4) For example, assume an employer pays its employees a mileage allowance at a rate of 35 cents per mile (when the business standard mileage rate is 32.5 cents per mile). The employer does not require the return of the portion of the allowance (2.5 cents) that exceeds the business standard mileage rate for the business miles substantiated. In June, the employer advances an employee $175 for 500 miles to be traveled during the month. In July, the employee substantiates to the employer 400 business miles traveled in June and returns $35 to the employer for the 100 business miles not traveled. The amount deemed substantiated for the 400 miles traveled is $130 and the employee is not required to return the remaining $10. No later than the first payroll period following the payroll period in which the 400 business miles traveled are substantiated, the employer must withhold and pay employment taxes on $10.

.02 The portion of a FAVR allowance, if any, that exceeds the amount deemed substantiated for those miles under section 9.01(2) of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62–2(h)-(2)(i)(B).

(1) Any periodic variable rate payment that relates to miles in excess of the business miles substantiated by the employee and that the employee fails to return within a reasonable period, or any portion of a periodic fixed payment that relates to a period during which the employee is treated as not covered by the FAVR allowance and that the employee fails to return within a reasonable period, is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)-(2)(i)(A).

(2) Any optional high mileage payment is subject to withholding and payment of employment taxes when paid.

SECTION 11. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96-63, 1996–2 C.B. 420, is hereby superseded for mileage allowances paid to an employee on or after January 1, 1998, with respect to transportation expenses paid or incurred on or after January 1, 1998, and, for purposes of computing the amount allowable as a deduction, for transportation expenses paid or incurred on or after January 1, 1998.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon on (202) 622-4920 (not a toll-free call).

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, §§ 62, 162, 267, 274; 1.62–2, 1.162–17, 1.267(a)–1, 1.274–5T, 1.274(d)–1)

Rev. Proc. 97–59

SECTION 1. PURPOSE

This revenue procedure updates Rev. Proc. 96-64, 1996–2 C.B. 427, by providing rules under which the amount of ordinary and necessary business expenses of an employee for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home will be deemed substantiated under § 1.274–5T of the temporary Income Tax Regulations when a payor (the employer, its agent, or a third party) provides a per diem allowance under a reimbursement or other expense allowance arrangement to pay for such expenses. This revenue procedure also provides an optional method for employees and self-employed individuals to use in computing the deductible costs of business meal and incidental expenses paid or incurred while traveling away from home. Use of a method described in this revenue procedure is not mandatory and a taxpayer may use actual allowable expenses if the taxpayer maintains adequate records or other sufficient evidence for proper substantiation. This revenue procedure does not provide rules under which the amount of an employee's lodging expenses will be deemed substantiated when a payor provides an allowance to pay for those expenses but not meal and incidental expenses.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 162(a) of the Internal Revenue Code allows a deduction for all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct expenses paid or incurred while traveling away from home in pursuit of a trade or business. However, under § 262, no portion of such travel expenses that is attributable to personal, living, or family expenses is deductible.

.02 Section 274(n) generally limits the amount allowable as a deduction under § 162 for any expense for food, beverages, or entertainment to 50 percent of the amount of the expense that otherwise would be allowable as a deduction. In the case of any expenses for food or beverages consumed while away from home (within the meaning of § 162(a)(2)) by an individual during, or incident to, the period of duty subject to the hours of services limitations of the Department of Transportation, § 274(n)(3), as added by § 969 of the Taxpayer Relief Act of 1997, Pub. L. No. 105–34, 111 Stat. 788 (August 5, 1997), gradually increases the deductible percentage to 80 percent for taxable years beginning in 2008. For taxable years beginning in 1998, the deductible percentage for these expenses is 55 percent.

.03 Section 274(d) provides, in part, that no deduction shall be allowed under § 162 for any traveling expense (including meals and lodging while away from home) unless the taxpayer complies with certain substantiation requirements. The section further provides that regulations may prescribe that some or all of the substantiation requirements do not apply to an expense that does not exceed an amount prescribed by such regulations.

.04 Section 1.274(d)–1(a) of the regulations, in part, grants the Commissioner the authority to prescribe rules relating to reimbursement arrangements or per diem allowances for ordinary and necessary expenses paid or incurred while traveling away from home. Pursuant to this grant of authority, the Commissioner may prescribe rules under which such arrangements or allowances, if in accordance with reasonable business practice, will be regarded (1) as equivalent to substantiation, by adequate records or other sufficient evidence, of the amount of such travel expenses for purposes of § 1.274–5T(c), and (2) as satisfying the requirements of an adequate accounting to the employer of the amount of such travel expenses for purposes of § 1.274–5T(f).

.05 For purposes of determining adjusted gross income, § 62(a)(2)(A) allows an employee a deduction for expenses allowed by Part VI (§ 161 and following), subchapter B, chapter 1 of the Code, paid or incurred by the employee in connection with the performance of services as an employee under a reimbursement or other expense allowance arrangement with a payor.

.06 Section 62(c) provides that an arrangement will not be treated as a reimbursement or other expense allowance arrangement for purposes of § 62(a)(2)(A) if it—

(1) does not require the employee to substantiate the expenses covered by the arrangement to the payor, or

(2) provides the employee with the right to retain any amount in excess of the substantiated expenses covered under the arrangement.

Section 62(c) further provides that the substantiation requirements described therein shall not apply to any expense to the extent that, under the grant of regulatory authority prescribed in § 274(d), the Commissioner has provided that substantiation is not required for such expense.

.07 Under § 1.62–2(c)(1) a reimbursement or other expense allowance arrangement satisfies the requirements of § 62(c) if it meets the requirements of business connection, substantiation, and returning amounts in excess of expenses as specified in the regulations. Section 1.62–2(e)(2) specifically provides that substantiation of certain business expenses in accordance with rules prescribed under the authority of § 1.274(d)–1(a) or 1.274–5T(j) will be treated as substantiation of the amount of such expenses for purposes of § 1.62–2. Under § 1.62–2(f)(2), the Commissioner may prescribe rules under which an

arrangement providing per diem allowances will be treated as satisfying the requirement of returning amounts in excess of expenses, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated pursuant to rules prescribed under § 274(d), provided the allowance is reasonably calculated not to exceed the amount of the employee's expenses or anticipated expenses and the employee is required to return any portion of such an allowance that relates to days of travel not substantiated.

.08 Section 1.62–2(h)(2)(i)(B) provides that if a payor pays a per diem allowance that meets the requirements of § 1.62–2(c)(1), the portion, if any, of the allowance that relates to days of travel substantiated in accordance with § 1.62–2(e), that exceeds the amount of the employee's expenses deemed substantiated for such travel pursuant to rules prescribed under § 274(d) and § 1.274(d)–1(a) or § 1.274–5T(j), and that the employee is not required to return, is subject to withholding and payment of employment taxes. See §§ 31.3121(a)–3, 31.3231(e)–1(a)(5), 31.3306(b)–2, and 31.3401(a)–4. Because the employee is not required to return this excess portion, the reasonable period of time provisions of § 1.62–2(g) (relating to the return of excess amounts) do not apply to this portion.

.09 Under § 1.62–2(h)(2)(i)(B)(*4*), the Commissioner may, in his or her discretion, prescribe special rules regarding the timing of withholding and payment of employment taxes on per diem allowances.

.10 Section 1.274–5T(j) grants the Commissioner the authority to establish a method under which a taxpayer may elect to use a specified amount for meals paid or incurred while traveling away from home in lieu of substantiating the actual cost of meals.

.11 Significant changes to this revenue procedure include:

(1) revisions to the list of high-cost localities and high-low rates for purposes of the high-low substantiation method (section 5);

(2) modification of how to prorate the Federal M&IE rate for partial days of travel to reflect an amendment to the Federal Travel Regulations by 61 Fed. Reg. 68,158 (1996) (to be codified at 41 C.F.R. § 301–7.8) (section 6.04); and

(3) modification of the limitation on the deduction of meal expenses to reflect an amendment to § 274(n) (as described in section 2.02 of this revenue procedure) (sections 6.05 and 7).

SECTION 3. DEFINITIONS

.01 *Per diem allowance*. The term "per diem allowance" means a payment under a reimbursement or other expense allowance arrangement that meets the requirements specified in § 1.62–2(c)(1) and that is

(1) paid with respect to ordinary and necessary business expenses incurred, or which the payor reasonably anticipates will be incurred, by an employee for lodging, meal, and incidental expenses or for meal and incidental expenses for travel away from home in connection with the performance of services as an employee of the employer,

(2) reasonably calculated not to exceed the amount of the expenses or the anticipated expenses, and

(3) paid at or below the applicable Federal per diem rate, a flat rate or stated schedule, or in accordance with any other Service-specified rate or schedule.

.02 *Federal per diem rate*.

(1) *General rule*. The Federal per diem rate is equal to the sum of the Federal lodging expense rate and the Federal meal and incidental expense (M&IE) rate for the locality of travel. Each of these rates for a particular locality in the continental United States ("CONUS") is set forth in Appendix A of 41 C.F.R., Chapter 301, as amended. See 41 C.F.R. Part 301–7 (1996), as amended, for specific rules regarding these Federal rates. Each of these rates is established by the Secretary of Defense for a particular nonforeign locality outside the continental United States ("OCONUS") (including Alaska, Hawaii, Puerto Rico, the Northern Mariana Islands, and the possessions of the United States), and by the Secretary of State for a particular foreign OCONUS locality. Each of these OCONUS rates is published in the Per Diem Supplement to the Standardized Regulations (Government Civilians, Foreign Areas). See, *e.g.*, Maximum Travel Per Diem Allowances for Foreign Areas, PD Supplement 382, issued March 1, 1996.

(2) *Locality of travel*. The term "locality of travel" means the locality where an employee traveling away from home in connection with the performance of services as an employee of the employer stops for sleep or rest.

(3) *Incidental expenses*. The term "incidental expenses" includes, but is not limited to, expenses for laundry, cleaning and pressing of clothing, and fees and tips for services, such as for porters and baggage carriers. The term "incidental expenses" does not include taxicab fares or the costs of telegrams or telephone calls.

.03 *Flat rate or stated schedule*.

(1) *In general*. Except as provided in section 3.03(2) of this revenue procedure, an allowance is paid at a flat rate or stated schedule if it is provided on a uniform and objective basis with respect to the expenses described in section 3.01 of this revenue procedure. Such allowance may be paid with respect to the number of days away from home in connection with the performance of services as an employee or on any other basis that is consistently applied and in accordance with reasonable business practice. Thus, for example, an hourly payment to cover meal and incidental expenses paid to a pilot or flight attendant who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule. Likewise, a payment based on the number of miles traveled (*e.g.*, cents per mile) to cover meal and incidental expenses paid to an over-the-road truck driver who is traveling away from home in connection with the performance of services as an employee is an allowance paid at a flat rate or stated schedule.

(2) *Limitation*. For purposes of this revenue procedure, an allowance that is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced) does not meet the business connection requirement of § 1.62–2(d), is not a per diem allowance, and is not paid at a flat rate or stated schedule, unless, as of December 12, 1989, (a) the allowance was identified by the payor either by making a separate payment or by specifically identifying the amount of the allowance,

or (b) an allowance computed on that basis was commonly used in the industry in which the employee is employed. See § 1.62–2(d)(3)(ii).

SECTION 4. PER DIEM SUBSTANTIATION METHOD

.01 *Per diem allowance*. If a payor pays a per diem allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the per diem allowance for such day or the amount computed at the Federal per diem rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.02 *Meals only per diem allowance*. If a payor pays a per diem allowance only for meal and incidental expenses in lieu of reimbursing actual expenses for meal and incidental expenses incurred or to be incurred by an employee for travel away from home, the amount of the expenses that is deemed substantiated for each calendar day is equal to the lesser of the per diem allowance for such day or the amount computed at the Federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure). A per diem allowance is treated as paid only for meal and incidental expenses if (1) the payor pays the employee for actual expenses for lodging based on receipts submitted to the payor, (2) the payor provides the lodging in kind, (3) the payor pays the actual expenses for lodging directly to the provider of the lodging, (4) the payor does not have a reasonable belief that lodging expenses were or will be incurred by the employee, or (5) the allowance is computed on a basis similar to that used in computing the employee's wages or other compensation (*e.g.*, the number of hours worked, miles traveled, or pieces produced).

.03 *Optional method for meals only deduction*. In lieu of using actual expenses, employees and self-employed individuals, in computing the amount allowable as a deduction for ordinary and necessary meal and incidental expenses paid or incurred for travel away from home, may use an amount computed at the Federal M&IE rate for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee or self-employed individual is away from home. Such amount will be deemed substantiated for purposes of paragraphs (b)(2) (travel away from home) and (c) of § 1.274–5T, provided the employee or self-employed individual substantiates the elements of time, place, and business purpose of the travel expenses in accordance with those regulations.

.04 *Special rules for transportation industry*.

(1) *In general*. This section 4.04 applies to (a) a payor that pays a per diem allowance only for meal and incidental expenses for travel away from home as described in section 4.02 of this revenue procedure to an employee in the transportation industry, or (b) an employee or self-employed individual in the transportation industry who computes the amount allowable as a deduction for meal and incidental expenses for travel away from home in accordance with section 4.03 of this revenue procedure.

(2) *Rates*. A taxpayer described in section 4.04(1) of this revenue procedure may treat $36 as the Federal M&IE rate for any locality of travel in CONUS, and/or $40 as the Federal M&IE rate for any locality of travel OCONUS. A payor that uses either (or both) of these special rates with respect to an employee must use the special rate(s) for all amounts subject to section 4.02 of this revenue procedure paid to that employee for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year. Similarly, an employee or self-employed individual that uses either (or both) of these special rates must use the special rate(s) for all amounts computed pursuant to section 4.03 of this revenue procedure for travel away from home within CONUS and/or OCONUS, as the case may be, during the calendar year.

(3) Periodic rule. A payor described in section 4.04(1) of this revenue procedure may compute the amount of the employee's expenses that is deemed substantiated under section 4.02 of this revenue procedure periodically (not less frequently than monthly), rather than daily, by comparing the total per diem allowance paid for the period to the sum of the amounts computed at the Federal M&IE rate(s) for the localities of travel for the days (or partial days, see section 6.04 of this revenue procedure) the employee is away from home during the period. For example, assume an employee in the transportation industry travels away from home within CONUS on 17 days (including partial days, see section 6.04 of this revenue procedure) during a calendar month and receives a per diem allowance only for meal and incidental expenses from a payor that uses the special rule under section 4.04(2) of this revenue procedure. The amount deemed substantiated under section 4.02 of this revenue procedure is equal to the lesser of the total per diem allowance paid for the month or $612 (17 days at $36 per day).

(4) *Transportation industry defined*. For purposes of this section 4.04 of this revenue procedure, an employee or self-employed individual is "in the transportation industry" only if the employee's or individual's work (a) is of the type that directly involves moving people or goods by airplane, barge, bus, ship, train, or truck, and (b) regularly requires travel away from home which, during any single trip away from home, usually involves travel to localities with differing Federal M&IE rates. For purposes of the preceding sentence, a payor must determine that an employee or a group of employees is "in the transportation industry" by using a method that is consistently applied and in accordance with reasonable business practice.

SECTION 5. HIGH-LOW SUBSTANTIATION METHOD

.01 *General rule*. If a payor pays a per diem allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses incurred or to be incurred by an employee for travel away from home and the payor uses the high-low substantiation method described in this section 5 for travel within CONUS, the amount of the expenses that is deemed substantiated for each calendar day is

equal to the lesser of the per diem allowance for such day or the amount computed at the rate set forth in section 5.02 of this revenue procedure for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure). This high-low substantiation method may be used in lieu of the per diem substantiation method provided in section 4.01 of this revenue procedure, but may not be used in lieu of the meals only substantiation method provided in section 4.02 or 4.03 of this revenue procedure.

.02 *Specific high-low rates*. The per diem rate set forth in this section 5.02 is $180 for travel to any "high-cost locality" specified in section 5.03 of this revenue procedure, or $113 for travel to any other locality within CONUS. Whichever per diem rate applies, it is applied as if it were the Federal per diem rate for the locality of travel. For purposes of applying the high-low substantiation method, the Federal M&IE rate shall be treated as $40 for a high-cost locality and $32 for any other locality within CONUS.

.03 *High-cost localities*. The following localities have a Federal per diem rate of $147 or more for all or part of the calendar year, and are high-cost localities for all of the calendar year or the portion of the calendar year specified in parenthesis under the key city name:

Key city	County and other defined location
Arizona	
Grand Canyon	All points in the Grand Canyon National Park and Kaibab National Forest within Coconino County
California	
Los Angeles	Los Angeles, Kern, Orange, and Ventura Counties; Edwards Air Force Base, Naval Weapons Center and Ordnance Test Station, China Lake
Napa (April 1-October 31)	Napa
Palo Alto/San Jose	Santa Clara
Point Arena/Gualala	Mendocino
San Francisco	San Francisco
Colorado	
Aspen	Pitkin
Keystone/Silverthorne	Summit
Telluride	San Miquel
Vail (November 1-March 31)	Eagle
Delaware	
Lewes (June 1-September 14)	Sussex
District of Columbia	
Washington, D.C.	Washington, D.C.; the cities of Alexandria, Falls Church, and Fairfax, and the counties of Arlington, Loudoun, and Fairfax in Virginia; and the counties of Montgomery and Prince George's in Maryland
Florida	
Key West (December 15-April 30)	Monroe
Naples December 15-April 30)	Collier
Illinois	
Chicago	Du Page, Cook, and Lake
Indiana	
Nashville (June 1-October 31)	Brown
Maine	
Bar Harbor (July 1-September 14)	Hancock
Maryland	
(For the counties of Montgomery and Prince George's, see District of Columbia)	
Baltimore	Baltimore and Harford
Ocean City (May 1-September 30)	Worcester
Saint Michaels (April 1-November 30)	Talbot

Key city	County and other defined location
Maryland—Continued	
Massachusetts	
Boston	Suffolk
Cambridge/Lowell	Middlesex
Martha's Vineyard (June 1-October 31)	Dukes
Nantucket (June 1-October 31)	Nantucket
Nevada	
Incline Village (June 1-September 30)	All points in the Northern Lake Tahoe area within Washoe County
New Hampshire	
Hanover (June 1-October 31)	Grafton and Sullivan
New Jersey	
Ocean City/Cape May (May 15-September 30)	Cape May
Parsippany/Dover	Morris; Picatinny Arsenal
New Mexico	
Santa Fe (May 1-October 31)	Santa Fe
New York	
New York City	The boroughs of Bronx, Brooklyn, Manhattan, Queens, and Staten Island; Nassau and Suffolk Counties
Tarrytown/White Plains	Westchester
North Carolina	
Kill Devil/Duck/ Outer Banks (May 1-September 30)	Dare
Pennsylvania	
Philadelphia	Philadelphia; city of Bala Cynwyd in Montgomery County
Rhode Island	
Newport/Block Island (May 1-October 14)	Newport and Washington
South Carolina	
Hilton Head (March 1-September 30)	Beaufort
Myrtle Beach (May 1-September 30)	Horry; Myrtle Beach Air Force Base
Utah	
Park City (December 1-March 31)	Summit
Virginia	
(For the cities of Alexandria, Fairfax, and Falls Church, and the counties of Arlington, Fairfax, and Loudoun, see District of Columbia)	
Washington	
Friday Harbor (June 1-October 31)	San Juan
Seattle	King
Wyoming	
Jackson (June 1-October 14)	Teton

.04 *Changes in high-cost localities*. The list of high-cost localities in section 5.03 of this revenue procedure differs from the list of high-cost localities in section 5.03 of Rev. Proc. 96-64. The following localities have been added to the list of high-cost localities: Napa, California; Lewes, Delaware; Naples, Florida; Baltimore, Maryland; Hanover, New Hampshire; Parsippany/Dover, New Jersey; Tarrytown, New York; Kill Devil, North Carolina; Hilton Head, South Carolina; Myrtle Beach, South Carolina; Friday Harbor, Washington; and Seattle, Washington. The portion of the year for which the following are high-cost localities has been changed: Aspen, Colorado; Key West, Florida; Saint Michaels, Maryland; Martha's Vineyard, Massachusetts; Nantucket, Massachusetts; and Incline Village, Nevada. The following localities have been removed from the list of high-cost localities: Phoenix/Scottsdale, Arizona; South Lake Tahoe, California; Yosemite National Park, California; Steamboat Springs, Colorado; Hyannis, Massachusetts; Leland, Michigan; Mackinac Island, Michigan; Stateline, Nevada; Atlantic City, New Jersey; Sandusky, Ohio; Chester/Radnor, Pennsylvania; Bullfrog, Utah; Virginia Beach, Virginia; Wintergreen, Virginia; and Wisconsin Dells, Wisconsin.

.05 S*pecific limitation*. A payor that uses the high-low substantiation method with respect to an employee must use that method for all amounts paid to that employee for travel away from home within CONUS during the calendar year. However, with respect to that employee, the payor may still reimburse actual expenses or use the meals only per diem method described in section 4.02 of this revenue procedure for any travel away from home, and may use the per diem substantiation method described in section 4.01 of this revenue procedure for any OCONUS travel away from home.

SECTION 6. LIMITATIONS AND SPECIAL RULES

.01 *In general*. The Federal per diem rate and the Federal M&IE rate described in section 3.02 of this revenue procedure for the locality of travel will be applied in the same manner as applied under the Federal Travel Regulations, 41 C.F.R. Part 301–7 (1996), except as provided in sections 6.02 through 6.04 of this revenue procedure.

.02 *Federal per diem rate*. A receipt for lodging expenses is not required in determining the amount of expenses deemed substantiated under section 4.01 or 5.01 of this revenue procedure. See section 7.01 of this revenue procedure for the requirement that the employee substantiate the time, place, and business purpose of the expense.

.03 *Federal per diem or M&IE rate*. A payor is not required to reduce the Federal per diem rate or the Federal M&IE rate for the locality of travel for meals provided in kind, provided the payor has a reasonable belief that meal and incidental expenses were or will be incurred by the employee.

.04 *Proration of the Federal per diem or M&IE rate*. Pursuant to the Federal Travel Regulations, in determining the Federal per diem rate or the Federal M&IE rate for the locality of travel, the full applicable Federal M&IE rate is available for a full day of travel from 12:01 a.m. to 12:00 midnight. For purposes of determining the amount deemed substantiated under section 4 or 5 of this revenue procedure with respect to partial days of travel away from home, either of the following methods may be used to prorate the Federal M&IE rate to determine the Federal per diem rate or the Federal M&IE rate for the partial days of travel:

(1) Such rate may be prorated using the method prescribed by the Federal Travel Regulations. Currently the Federal Travel Regulations allow three-fourths of the applicable Federal M&IE rate for each partial day during which the employee or self-employed individual is traveling away from home in connection with the performance of services as an employee or self-employed individual; or

(2) Such rate may be prorated using any method that is consistently applied and in accordance with reasonable business practice. For example, if an employee travels away from home from 9 a.m. one day to 5 p.m. the next day, a method of proration that results in an amount equal to 2 times the Federal M&IE rate will be treated as being in accordance with reasonable business practice (even though only 1 1/2 times the Federal M&IE rate would be allowed under the Federal Travel Regulations).

.05 *Application of the appropriate § 274(n) limitation on meal expenses*. All or part of the amount of an expense deemed substantiated under this revenue procedure is subject to the appropriate limitation under § 274(n) (see section 2.02 of this revenue procedure) on the deductibility of food and beverage expenses.

(1) When an amount for meal and incidental expenses is computed pursuant to section 4.03 of this revenue procedure, the taxpayer must treat such amount as an expense for food and beverages.

(2) When a per diem allowance is paid only for meal and incidental expenses, the payor must treat an amount equal to the lesser of the allowance or the Federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure) as an expense for food and beverages.

(3) When a per diem allowance is paid for lodging, meal, and incidental expenses, the payor must treat an amount equal to the Federal M&IE rate for the locality of travel for each calendar day (or partial day, see section 6.04 of this revenue procedure) the employee is away from home as an expense for food and beverages. For purposes of the preceding sentence, when a per diem allowance for lodging, meal, and incidental expenses is paid at a rate that is less than the Federal per diem rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure), the payor may treat an amount equal to 40 percent of such allowance as the Federal M&IE rate for the locality of travel for such day (or partial day, see section 6.04 of this revenue procedure).

.06 *No double reimbursement or deduction*. If a payor pays a per diem allowance in lieu of reimbursing actual expenses for lodging, meal, and incidental expenses or for meal and incidental expenses in accordance with section 4 or 5 of this revenue procedure, any additional payment with respect to such expenses is treated as paid under a nonaccountable plan, is included in the employee's gross income, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. Similarly, if an employee or self-employed individual computes the amount allowable as a deduction for meal and incidental ex-

penses for travel away from home in accordance with section 4.03 or 4.04 of this revenue procedure, no other deduction is allowed to the employee or self-employed individual with respect to such expenses. For example, assume an employee receives a per diem allowance from a payor for lodging, meal, and incidental expenses or for meal and incidental expenses incurred while traveling away from home. During that trip, the employee pays for dinner for the employee and two business associates. The payor reimburses as a business entertainment meal expense the meal expense for the employee and the two business associates. Because the payor also pays a per diem allowance to cover the cost of the employee's meals, the amount paid by the payor for the employee's portion of the business entertainment meal expense is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes.

.07 *Related parties*. Sections 4.01, 4.02, 4.04 (to the extent it relates to section 4.02), and 5 of this revenue procedure will not apply in any case in which a payor and an employee are related within the meaning of § 267(b), but for this purpose the percentage of ownership interest referred to in § 267(b)(2) shall be 10 percent.

SECTION 7. APPLICATION

.01 If the amount of travel expenses is deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure, and the employee actually substantiates to the payor the elements of time, place, and business purpose of the travel expenses in accordance with paragraphs (b)(2) (travel away from home) and (c) (other than subparagraph (2)(iii)(A) thereof) of § 1.274–5T, the employee is deemed to satisfy the adequate accounting requirements of § 1.274–5T(f) as well as the requirement to substantiate by adequate records or other sufficient evidence for purposes of § 1.274–5T(c). See § 1.62–2(e)(1) for the rule that an arrangement must require business expenses to be substantiated to the payor within a reasonable period of time.

.02 An arrangement providing per diem allowances will be treated as satisfying the requirement of § 1.62–2(f)(2) with respect to returning amounts in excess of expenses if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) any portion of such an allowance that relates to days of travel not substantiated, even though the arrangement does not require the employee to return the portion of such an allowance that relates to days of travel substantiated and that exceeds the amount of the employee's expenses deemed substantiated. For example, assume a payor provides an employee an advance per diem allowance for meal and incidental expenses of $200, based on an anticipated 5 days of business travel at $40 per day to a locality for which the Federal M&IE rate is $34, and the employee substantiates 3 full days of business travel. The requirement to return excess amounts will be treated as satisfied if the employee is required to return within a reasonable period of time (as defined in § 1.62–2(g)) the portion of the allowance that is attributable to the 2 unsubstantiated days of travel ($80), even though the employee is not required to return the portion of the allowance ($18) that exceeds the amount of the employee's expenses deemed substantiated under section 4.02 of this revenue procedure ($102) for the 3 substantiated days of travel. However, the $18 excess portion of the allowance is treated as paid under a nonaccountable plan as discussed in section 7.04 of this revenue procedure.

.03 An employee is not required to include in gross income the portion of a per diem allowance received from a payor that is less than or equal to the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274–5T(f)(2)(i). In addition, such portion of the allowance is treated as paid under an accountable plan, is not reported as wages or other compensation on the employee's Form W–2, and is exempt from the withholding and payment of employment taxes. See § 1.62–2(c)(2) and (c)(4).

.04 An employee is required to include in gross income only the portion of the per diem allowance received from a payor that exceeds the amount deemed substantiated under the rules provided in section 4 or 5 of this revenue procedure if the employee substantiates the business travel expenses covered by the per diem allowance in accordance with section 7.01 of this revenue procedure. See § 1.274–5T(f)(2)(ii). In addition, the excess portion of the allowance is treated as paid under a nonaccountable plan, is reported as wages or other compensation on the employee's Form W-2, and is subject to withholding and payment of employment taxes. See § 1.62–2(c)(3)(ii), (c)(5), and (h)(2)(i)(B).

.05 If the amount of the expenses that is deemed substantiated under the rules provided in section 4.01, 4.02, or 5 of this revenue procedure is less than the amount of the employee's business expenses for travel away from home, the employee may claim an itemized deduction for the amount by which the business travel expenses exceed the amount that is deemed substantiated, provided the employee substantiates all the business travel expenses, includes on Form 2106, Employee Business Expenses, the deemed substantiated portion of the per diem allowance received from the payor, and includes in gross income the portion (if any) of the per diem allowance received from the payor that exceeds the amount deemed substantiated. See § 1.274–5T(f)(2)(iii). However, for purposes of claiming this itemized deduction with respect to meal and incidental expenses, substantiation of the amount of the expenses is not required if the employee is claiming a deduction that is equal to or less than the amount computed under section 4.03 of this revenue procedure minus the amount deemed substantiated under sections 4.02 and 7.01 of this revenue procedure. The itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor on miscellaneous itemized deductions provided in § 67.

.06 An employee who does not receive a per diem allowance for meal and incidental expenses may deduct an amount computed pursuant to section 4.03 of this revenue procedure only as an itemized deduction. This itemized deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n) and the 2-percent floor

on miscellaneous itemized deductions provided in § 67.

.07 A self-employed individual may deduct an amount computed pursuant to section 4.03 of this revenue procedure in determining adjusted gross income under § 62(a)(1). This deduction is subject to the appropriate limitation (see section 2.02 of this revenue procedure) on meal and entertainment expenses provided in § 274(n).

.08 If a payor's reimbursement or other expense allowance arrangement evidences a pattern of abuse of the rules of § 62(c) and the regulations thereunder, all payments under the arrangement will be treated as made under a nonaccountable plan. Thus, such payments are included in the employee's gross income, are reported as wages or other compensation on the employee's Form W-2, and are subject to withholding and payment of employment taxes. See § 1.62–2(c)(3), (c)(5), and (h)(2).

SECTION 8. WITHHOLDING AND PAYMENT OF EMPLOYMENT TAXES.

.01 The portion of a per diem allowance, if any, that relates to the days of business travel substantiated and that exceeds the amount deemed substantiated for those days under section 4.01, 4.02, or 5 of this revenue procedure is subject to withholding and payment of employment taxes. See § 1.62–2(h)(2)(i)(B).

.02 In the case of a per diem allowance paid as a reimbursement, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes in the payroll period in which the payor reimburses the expenses for the days of travel substantiated. See § 1.62–2(h)(2)(i)(B)(*2*).

.03 In the case of a per diem allowance paid as an advance, the excess described in section 8.01 of this revenue procedure is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the days of travel with respect to which the advance was paid are substantiated. See § 1.62–2(h)(2)(i)-(B)(*3*). If some or all of the days of travel with respect to which the advance was paid are not substantiated within a reasonable period of time and the employee does not return the portion of the allowance that relates to those days within a reasonable period of time, the portion of the allowance that relates to those days is subject to withholding and payment of employment taxes no later than the first payroll period following the end of the reasonable period. See § 1.62–2(h)(2)(i)(A).

.04 In the case of a per diem allowance only for meal and incidental expenses for travel away from home paid to an employee in the transportation industry by a payor that uses the rule in section 4.04(3) of this revenue procedure, the excess of the per diem allowance paid for the period over the amount deemed substantiated for the period under section 4.02 of this revenue procedure (after applying section 4.04(3) of this revenue procedure), is subject to withholding and payment of employment taxes no later than the first payroll period following the payroll period in which the excess is computed. See § 1.62-2(h)(2)(i)(B)(4).

.05 For example, assume that an employer pays an employee a per diem allowance to cover business expenses for meals and lodging for travel away from home at a rate of 120 percent of the Federal per diem rate for the localities to which the employee travels. The employer does not require the employee to return the 20 percent by which the reimbursement for those expenses exceeds the Federal per diem rate. The employee substantiates 6 days of travel away from home: 2 days in a locality in which the Federal per diem rate is $100 and 4 days in a locality in which the Federal per diem rate is $125. The employer reimburses the employee $840 for the 6 days of travel away from home (2 × (120% × $100) +4 × (120% × $125)), and does not require the employee to return the excess payment of $140 ((2 days × $20 ($120–$100) + 4 days x $25 ($150–$125)). For the payroll period in which the employer reimburses the expenses, the employer must withhold and pay employment taxes on $140. See section 8.02 of this revenue procedure.

SECTION 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–64 is hereby superseded for per diem allowances paid to an employee on or after January 1, 1998, with respect to lodging, meal, and incidental expenses or with respect to meal and incidental expenses paid or incurred for travel while away from home on or after January 1, 1998, and, for purposes of computing the amount allowable as a deduction, for meal and incidental expenses paid or incurred by an employee or self-employed individual for travel while away from home on or after January 1, 1998.

DRAFTING INFORMATION

The principal author of this revenue procedure is Edwin B. Cleverdon of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Mr. Cleverdon on (202) 622-4920 (not a toll-free call).

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26 CFR 601.602: Tax forms and instructions. (Also Part I, sections 6012, 6061; 1.6012–5, 1.6061–1)

Rev. Proc. 97–60

CONTENTS

SECTION 1. PURPOSE

This revenue procedure informs those who participate in the Form 1040 Electronic Filing (ELF) Program of their obligations to the Internal Revenue Service, taxpayers, and other participants. The following returns can be filed under the Form 1040 ELF Program: (1) 1997 Form 1040 and 1997 Form 1040A, U.S. Individual Income Tax Return; and (2) 1997 Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents. This revenue procedure updates and supersedes Rev. Proc. 96-61, 1996–2 C.B. 401.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 1.6012–5 of the Income Tax Regulations provides that the Commissioner may authorize the use, at the option of a person required to make a return, of a composite return in lieu of any form specified in 26 CFR Part 1 (Income Tax), subject to the conditions, limitations, and special rules governing the preparation, execution, filing, and correction thereof as the Commissioner may deem appropriate.

.02 For purposes of this revenue procedure, an electronically filed Form 1040, Form 1040A, or Form 1040EZ is a composite return consisting of electronically transmitted data and certain paper documents. The paper portion of the return consists of Form 8453, U.S. Individual Income Tax Declaration for Electronic Filing, and other paper documents that cannot be electronically transmitted. Form 8453 must be received by the Service before the composite return is considered filed (see section 5.08 of this revenue procedure). The composite return must contain the same information that a return filed completely on paper contains. See section 7 of this revenue procedure for procedures for completing Form 8453.

.03 The Service will periodically issue Publication 1345, Handbook for Electronic Filers of Individual Income Tax Returns, that lists the forms and schedules associated with the Form 1040 series that can be electronically transmitted.

.04 For the purposes of the Form 1040 ELF Program, a 1997 Form 1040, Form 1040A, or Form 1040EZ cannot be electronically filed after October 15, 1998, notwithstanding the fact that the taxpayer has been granted an extension to file a return beyond that date.

.05 An amended tax return cannot be electronically filed under the Form 1040 ELF Program. A taxpayer must file an amended tax return on paper in accordance with the instructions for Form 1040X, Amended U.S. Individual Income Tax Return.

.06 A tax return that has a foreign address for the taxpayer cannot be electronically filed under the Form 1040 ELF Program. Army/Air Force (APO) and Fleet (FPO) post offices are not considered foreign addresses.

.07 A tax return for a decedent cannot be electronically filed under the Form 1040 ELF Program. The decedent's spouse or personal representative must file a paper tax return for the decedent.

.08 This revenue procedure updates and supersedes Rev. Proc. 96–61, 1996–2 C.B. 401. The updates include changes in the Form 1040 ELF Program, clarification of prior Form 1040 ELF Program statements, and additional guidance derived from other Service documents that relate to the Form 1040 ELF Program. Some of the updates are:

(1) additional fingerprint cards are not required for an application to operate an electronic filing business at a new location (section 4.02(4));

(2) the application period for the Form 1040 ELF Program runs from September 2, 1997, through December 1, 1997 (section 4.05(1));

(3) a proof of sale must be attached to an application from the purchaser of an existing Electronic Filer (section 4.05(2));

(4) all applications for the Form 1040 ELF Program must be sent to the Andover Service Center (sections 4.07 and 5.07);

(5) the definition of Responsible Official is clarified to reflect that a Responsible Official may also be a Principal (section 4.11));

(6) an individual who is an attorney may submit evidence of professional status in lieu of a fingerprint card provided the individual is not currently under suspension or disbarment from practice before the Service or the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia (section 4.13(1));

(7) an individual who is a certified public accountant may submit evidence of professional status in lieu of a fingerprint card provided the individual is not currently under suspension or disbarment from practice before the Service, or whose license to practice is not currently suspended or revoked by any State, Commonwealth, possession, territory, or the District of Columbia (section 4.13(2));

(8) timely notification that an Electronic Filer has discontinued participation in the Form 1040 ELF Program must be sent to the Andover Service Center (section 5.07);

(9) the complete paper copy of the return furnished to the taxpayer need not include the social security number of the paid preparer (section 8.01);

(10) a printout of the electronic portion of the return does not have to be provided to the taxpayer if the taxpayer provided a completed tax return for electronic filing and the information on the electronic por-

tion of the return is identical to the information on the completed tax return (section 8.01); and

(11) the Andover Service Center is the office responsible for accepting or rejecting an application to participate in the Form 1040 ELF Program (sections 14.02 through 14.07).

SECTION 3. ELECTRONIC FILING PARTICIPANTS—DEFINITIONS

.01 After acceptance into the Form 1040 ELF Program, as described in section 4 of this revenue procedure, a participant is referred to as an "Electronic Filer."

.02 The Electronic Filer categories are:

(1) ELECTRONIC RETURN ORIGINATOR. An "Electronic Return Originator" (ERO) is: (a) an "Electronic Return Preparer" who prepares tax returns, including Forms 8453, for taxpayers who intend to have their returns electronically filed; and/or (b) an "Electronic Return Collector" who accepts completed tax returns, including Forms 8453, from taxpayers who intend to have their returns electronically filed.

(2) SERVICE BUREAU. A "Service Bureau" receives tax return information on any media from an ERO, formats the return information, and either forwards the return information to a Transmitter or sends back the return information to the ERO. A Service Bureau may send Forms 8453 to the appropriate service center.

(3) SOFTWARE DEVELOPER. A "Software Developer" develops software for the purposes of (a) formatting returns according to the Service's electronic return specifications; and/or (b) transmitting electronic returns directly to the Service. A Software Developer may also sell its software.

(4) TRANSMITTER. A "Transmitter" transmits the electronic portion of a return directly to the Service. An entity that provides a "bump-up" service is a Transmitter. A bump-up service provider increases the transmission rate or line speed of formatted or reformatted information that is being sent to the Service via a public switched telephone network. The Service accepts both asynchronous and bisynchronous communications protocols.

.03 The Electronic Filer categories are not mutually exclusive. For example, an ERO can, at the same time, be considered a Transmitter, Software Developer, or Service Bureau depending on the function(s) performed.

.04 An Electronic Filer may have a "Drop-Off Collection Point(s)." The activity at a Drop-Off Collection Point is limited solely to receiving a return or return information that a taxpayer wants to have electronically filed and collecting a fee for electronically filing that return. Return preparation activity may not be conducted at a Drop-Off Collection Point. Return preparation activity includes, but is not limited to, comparing amounts listed on Form 8453 with those on the paper return or return information provided by a taxpayer and verifying routing numbers and account numbers used for direct deposit of refunds. Return preparation activity does not include collecting a fee for electronic filing or ensuring that the taxpayer has signed Form 8453. An Electronic Filer need not have an ownership interest in the Drop-Off Collection Point.

SECTION 4. ACCEPTANCE IN THE FORM 1040 ELECTRONIC FILING PROGRAM

.01 Except as provided in sections 4.02 through 4.04 of this revenue procedure, an Electronic Filer that actively participated in the most recent Form 1040 ELF Program does not have to reapply to participate in the Form 1040 ELF Program. However, an Electronic Filer that intends to participate as a Transmitter or a Software Developer in the Form 1040 ELF Program must first successfully complete the testing referred to in section 4.08 of this revenue procedure. In addition, section 4.15 of this revenue procedure provides for the Service's issuance of credentials necessary for participation in the Form 1040 ELF Program.

.02 Applicants and Electronic Filers must file a new Form 8633, Application to Participate in the Electronic Filing Program, with completed fingerprint cards for the appropriate individuals, if:

(1) the applicant has never participated in the Form 1040 ELF Program;

(2) the applicant has previously been denied participation in the Form 1040 ELF Program;

(3) the applicant has been suspended from the Form 1040 ELF Program; or

(4) the Electronic Filer is participating in the Form 1040 ELF Program and wants to operate an electronic filing business at an additional location (except that an individual listed on the Electronic Filer's application who has previously submitted a fingerprint card does not need to submit an additional fingerprint card).

.03 To participate in the Form 1040 ELF Program, an Electronic Filer in the most recent Form 1040 ELF Program must submit a revised Form 8633, signed by all "Principals" and the "Responsible Official" (as described in sections 4.09 through 4.12 of this revenue procedure), with completed fingerprint cards for the appropriate individuals, if:

(1) the Electronic Filer functioned solely as a Software Developer during the most recent Form 1040 ELF Program and intends to function as an ERO, Service Bureau, or Transmitter during the Form 1040 ELF Program;

(2) there is an additional Principal, such as a partner or a corporate officer, that must be listed on Form 8633, line 8, "Principals of Your Firm or Organization";

(3) there is a Principal listed on Form 8633, line 8, that should be deleted; or

(4) the Responsible Official on Form 8633, line 9 changes.

.04 Except as provided in section 4.03 of this revenue procedure, to participate in the Form 1040 ELF Program, an Electronic Filer in the most recent Form 1040 ELF Program must submit either a revised Form 8633, or a letter containing the same information contained in a revised Form 8633, if any information on the Electronic Filer's Form 8633 has changed. A revised Form 8633 or letter submitted under this section should include only the information requested on lines 1a through 1i of Form 8633 and the information being revised. A Principal or a Responsible Official must sign the revised Form 8633 or the letter.

.05 Applicants and Electronic Filers described in section 4.02 of this revenue procedure must submit new applications within the following time periods:

(1) except as provided in section 4.05(2) of this revenue procedure, the application period runs from September 2, 1997, through December 1, 1997; and

(2) if an applicant purchases an existing Electronic Filer's business on or after November 1, 1997, a new application with

proof of sale attached must be submitted within 30 days after the date of the purchase.

.06 Revised applications described in sections 4.03 and 4.04 of this revenue procedure must be submitted within 30 days of the change(s) reflected on the revised Form 8633 or in the letter.

.07 Applicants and Electronic Filers described in sections 4.02 through 4.04 of this revenue procedure must file Form 8633 (or a letter as provided in section 4.04 of this revenue procedure) with the Andover Service Center.

.08 Applicants and Electronic Filers described in sections 4.01 through 4.04 of this revenue procedure that intend to participate as a Transmitter or a Software Developer in the Form 1040 ELF Program must first successfully complete the necessary testing at the appropriate service center(s).

.09 Each individual listed as a Principal or a Responsible Official must:

(1) be a United States citizen or an alien lawfully admitted for permanent residence as described in 8 U.S.C. § 1101(a)-(20) (1994);

(2) have attained the age of 21 as of the date of application;

(3) submit with Form 8633 one standard fingerprint card with a full set of fingerprints taken by a law enforcement agency, except as provided in section 4.13 of this revenue procedure;

(4) pass a suitability check that includes a credit check, a tax compliance check, and a fingerprint check; and

(5) meet any applicable state and local licensing and/or bonding requirements in connection with the preparation of tax returns and the collection of prepared returns that taxpayers intend to have electronically filed. However, if the state and local licensing and/or bonding requirements apply to a business entity, the individual(s) must demonstrate that the business entity meets the requirements.

.10 A Principal for a firm or organization includes the following:

(1) Sole Proprietorship. The sole proprietor is the Principal for a sole proprietorship.

(2) Partnership. Each partner who has a 5 percent or more interest in the partnership is a Principal of the partnership. If no partner has at least a 5 percent or more interest in the partnership, the Principal is an individual authorized to act for the partnership in legal and/or tax matters (at least one such individual must be listed on Form 8633).

(3) Corporation. The President, Vice-President, Secretary, and Treasurer of the corporation are each a Principal of the corporation.

(4) Other. The Principal for a for-profit entity that is not a sole proprietorship, partnership, or corporation, is an individual authorized to act for the entity in legal and/or tax matters (at least one such individual must be listed on Form 8633).

.11 A Responsible Official is the individual who oversees the daily operations of an Electronic Filer's office. A Responsible Official may also be a Principal. As set forth in section 4.12 of this revenue procedure, a Responsible Official may be responsible for more than one office.

.12 The Responsible Official categories are:

(1) TIER I RESPONSIBLE OFFICIAL. A "Tier I Responsible Official" is a Responsible Official who does not meet the definition of a "Tier II Responsible Official." A Tier I Responsible Official should be able to visit on a daily basis each office for which he or she is listed as a Responsible Official. A Tier I Responsible Official may be listed on a maximum of ten applications (Forms 8633).

(2) TIER II RESPONSIBLE OFFICIAL. A "Tier II Responsible Official" is an individual who has participated in the Form 1040 ELF Program as a Responsible Official during at least the two most recent filing seasons and who has never been suspended from participation in the Form 1040 ELF Program. A Tier II Responsible Official should be able to visit on a daily basis any office for which he or she is listed as a Responsible Official. A Tier II Responsible Official may be listed on a maximum of twenty applications (Forms 8633).

.13 An individual may choose to submit evidence of the individual's professional status in lieu of a standard fingerprint card if the individual is:

(1) an attorney in good standing of the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia, and is not currently under suspension or disbarment from practice before the Service or the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia;

(2) a certified public accountant who is duly qualified to practice as a certified public accountant in any State, Commonwealth, possession, territory, or the District of Columbia, and is not currently under suspension or disbarment from practice before the Service or whose license to practice is not currently suspended or revoked by any State, Commonwealth, possession, territory, or the District of Columbia;

(3) an enrolled agent pursuant to part 10 of 31 C.F.R. Subtitle A;

(4) an officer of a publicly held corporation; or

(5) a banking official who is bonded and has been fingerprinted within the last two years.

.14 If an Electronic Filer has a foreign location, the stateside contact representative will receive all Service correspondence for the foreign location relating to the Form 1040 ELF Program.

.15 The Service will issue credentials to eligible applicants for the Form 1040 ELF Program, as well as Electronic Filers that do not have to reapply pursuant to section 4.01, 4.03, or 4.04 of this revenue procedure (provided they have first satisfactorily completed the testing described in section 4.08 of this revenue procedure if they intend to participate as a Transmitter or Software Developer). No one may participate in the Form 1040 ELF Program without the following credentials:

(1) a letter of acceptance into the Form 1040 ELF Program;

(2) an Electronic Filing Identification Number (EFIN) or a Service Bureau Identification Number (SBIN);

(3) if appropriate, an Electronic Transmitter Identification Number (ETIN); and

(4) if appropriate, a Collection Point Identification Number (CPIN).

.16 The Service will not issue a letter of acceptance to participate in the Form 1040 ELF Program to an ERO if the Service did not receive and accept during the most recent Form 1040 ELF Program any electronically filed returns containing the ERO's EFIN. In addition, an ERO may be dropped from the Form 1040 ELF Program if the Service does not receive and accept prior to April 15, 1998, any electronically filed returns containing the

ERO's EFIN. In either case, the Service will notify the ERO that it has been dropped from the Form 1040 ELF Program and explain what steps the ERO needs to take for future participation in the program.

.17 If an Electronic Filer is a Software Developer that performs no other function in the Form 1040 ELF Program but software development, no Principal or Responsible Official needs to pass a suitability check.

.18 If an Electronic Filer will have a Drop-Off Collection Point(s) (as defined in section 3.04 of this revenue procedure), an Electronic Filer must submit a Form 8633 that lists each Drop-Off Collection Point. By listing a Drop-Off Collection Point on Form 8633, an Electronic Filer becomes a "parent" in relation to a listed Drop-Off Collection Point.

.19 The Service may reject an application to participate in the Form 1040 ELF Program for the following reasons (this list is not all-inclusive). These reasons apply to any firm, organization, Principal, or Responsible Official listed on Form 8633:

(1) conviction of any criminal offense under the revenue laws of the United States, or of any offense involving dishonesty or breach of trust;

(2) failure to file timely and accurate tax returns, including returns indicating that no tax is due;

(3) failure to timely pay any tax liabilities;

(4) assessment of tax penalties; (5) suspension/disbarment from practice before the Service;

(6) disreputable conduct or other facts that would reflect adversely on the Form 1040 ELF Program;

(7) misrepresentation on an application;

(8) suspension or rejection from the program in a prior year;

(9) unethical practices in return preparation;

(10) stockpiling returns prior to official acceptance into the Form 1040 ELF Program (see section 5.14 of this revenue procedure);

(11) knowingly and directly or indirectly employing or accepting assistance from any firm, organization, or individual that is prohibited from applying to participate in the Form 1040 ELF Program (see section 13.10 of this revenue procedure) or that is suspended from participating in the Form 1040 ELF Program (see section 13.11 of this revenue procedure). This includes any individual whose actions resulted in the rejection or suspension of a corporation or a partnership from the Form 1040 ELF Program; or

(12) knowingly and directly or indirectly accepting employment as an associate, correspondent, or as a subagent from, or sharing fees with, any firm, organization, or individual that is prohibited from applying to participate in the Form 1040 ELF Program (see section 13.10 of this revenue procedure) or that is suspended from participating in the Form 1040 ELF Program (see section 13.11 of this revenue procedure). This includes any individual whose actions resulted in the rejection or suspension of a corporation or a partnership from the Form 1040 ELF Program.

SECTION 5. RESPONSIBILITIES OF AN ELECTRONIC FILER

.01 To ensure that complete returns are accurately and efficiently filed, an Electronic Filer must comply with all publications and notices of the Service relating to electronic filing. Currently, these publications and notices include:

(1) Publication 1345, Handbook for Electronic Filers of Individual Income Tax Returns, and Publication 1345A, Handbook for Electronic Filers of Individual Income Tax Returns (Supplement);

(2) Publication 1346, Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns;

(3) Publication 1436, Test Package for Electronic Filing of Individual Income Tax Returns; and

(4) Postings to the Electronic Filing System Bulletin Board (EFS Bulletin Board).

.02 An Electronic Filer must maintain a high degree of integrity, compliance, and accuracy.

.03 An Electronic Filer may accept returns for electronic filing only from taxpayers, from Drop-Off Collection Points as listed on the Electronic Filer's Form 8633 (see section 4.18 of this revenue procedure), or from another Electronic Filer.

.04 If the taxpayer's address on a Form W-2, Wage and Tax Statement, Form W-2G, Statement for Recipients of Certain Gambling Winnings, Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., Form 1040, Schedule C, Profit or Loss From Business (Sole Proprietorship), or Form 1040, Schedule C-EZ, Profit or Loss From Business - Short Version, or any other tax form is different than the taxpayer's address in the entity section of the electronic portion of the taxpayer's Form 1040, the ERO or the Service Bureau must input for transmission to the Service those addresses that differ from the taxpayer's address on the electronic portion of the taxpayer's Form 1040.

.05 If an Electronic Filer charges a fee for the electronic transmission of a tax return, the fee may not be based on a percentage of the refund amount or any other amount from the tax return. An Electronic Filer may not charge a separate fee for Direct Deposit. See section 9 of this revenue procedure.

.06 An Electronic Filer must submit a revised Form 8633 (or a letter as provided in section 4.04 of this revenue procedure) to the Andover Service Center within 30 days of when any of the conditions or changes described in section 4.03 or 4.04 of this revenue procedure occur. See section 4.06 of this revenue procedure.

.07 An Electronic Filer must notify the Andover Service Center within 30 days of discontinuing its participation in the Form 1040 ELF Program. This does not preclude reapplication in the future.

.08 An Electronic Filer must ensure that it promptly processes returns submitted to it for electronic filing. See sections 5.14, 5.15, 5.16, and 7.01 of this revenue procedure. However, an Electronic Filer that receives a return for electronic filing on or before the due date of the return must ensure that the electronic return is filed on or before that due date (including extensions). An electronic return is not considered filed until the electronic portion of the tax return has been acknowledged by the Service as accepted for processing and a completed and signed Form 8453 has been received by the Service. However, if the electronic portion of a return is successfully transmitted on or

shortly before the due date and the Electronic Filer complies with section 7.01 of this revenue procedure, the return will be deemed timely filed. If the electronic portion of a return is transmitted on or shortly before the due date and is ultimately rejected, but the Electronic Filer and the taxpayer comply with section 5.13 of this revenue procedure, the return will be deemed timely filed. For a balance due return, see section 11 of this revenue procedure for instructions on how to make a timely payment of tax.

.09 An Electronic Filer that functions as an ERO must:

(1) comply with the procedures for completing and securing Forms 8453 described in section 7 of this revenue procedure;

(2) comply with the procedures described in section 11 of this revenue procedure for handling a balance due return;

(3) while returns are being filed by the ERO, retain and make available to the Service upon request the following material at the business address from which a return was accepted for electronic filing:

(a) a copy of the signed Form 8453 and paper copies of Forms W–2, W–2G, and 1099–R;

(b) a complete copy of the electronic portion of the return (may be retained on magnetic media) that can be readily and accurately converted into an electronic transmission that the Service can process; and

(c) the acknowledgement file received from the Service or from a third party Transmitter; and

(4) retain until the end of the calendar year in which a return was filed, and make available to the Service upon request the materials described in section 5.09(3) of this revenue procedure at either the business address from which a return was electronically filed or from the contact representative named on Form 8633.

.10 An ERO who is the paid preparer of an electronic tax return must also retain for the prescribed amount of time the materials described in § 1.6107–1(b) that are required to be kept by an income tax return preparer.

.11 An ERO must identify the paid preparer (if any) in the appropriate field of the electronic return and ensure that the paid preparer signed Form 8453. If Form 8453 is not signed by the paid preparer, the ERO must attach to Form 8453 a copy of pages 1 and 2 of the Form 1040EZ, Form 1040A, or Form 1040 signed by the paid preparer. These copies must be marked "COPY-DO NOT PROCESS" to prevent duplicate filings.

.12 An ERO must ensure against the unauthorized use of its EFIN and, if applicable, the CPIN(s) issued to its Drop-Off Collection Point(s). An ERO must not transfer its EFIN or the CPIN(s) of its Drop-Off Collection Point(s) by sale, merger, loan, gift, or otherwise to another entity.

.13 If the Service rejects the electronic portion of a taxpayer's return (the Service states whether it accepts or rejects the electronic portion of a taxpayer's return in an "acknowledgment file"), and the reason for the rejection cannot be rectified by the actions described in section 6.02(3) of this revenue procedure, the ERO, within 24 hours of receiving the rejection, must take reasonable steps to inform the taxpayer that the taxpayer's return has not been filed. When the ERO advises the taxpayer that the taxpayer's return has not been filed, the ERO must provide the taxpayer with the reject code(s), an explanation of the reject code(s), and the sequence number of each reject code(s). If the taxpayer chooses not to have the electronic portion of the return corrected and transmitted to the Service, or if the electronic portion of the return cannot be accepted for processing by the Service, the taxpayer must file a paper return by the later of:

(1) the due date of the return; or

(2) ten calendar days after the date the Service gives notification that the electronic portion of the return is rejected or that the electronic portion of the return cannot be accepted for processing.

The paper return should include an explanation of why the return is being filed after the due date.

.14 An ERO is responsible for ensuring that stockpiling does not occur at its office(s) or Drop-Off Collection Point(s). Stockpiling means collecting returns from taxpayers or from another Electronic Filer prior to official acceptance into the Form 1040 ELF Program, or, after official acceptance into the Form 1040 ELF Program, waiting more than three calendar days to transmit a return to the Service after receiving the information necessary for an electronic transmission of a tax return.

.15 An Electronic Filer who participates as a Service Bureau must:

(1) deliver all electronic returns to a Transmitter or to the ERO who gave the electronic returns to the Service Bureau within three calendar days of receipt;

(2) retrieve the acknowledgement file from the Transmitter within one calendar day of receipt by the Transmitter;

(3) send the acknowledgement file to the ERO (whether related or not) within one work day of retrieving the acknowledgement file;

(4) if the Service Bureau processes Forms 8453, send back to the ERO any return and Form 8453 that needs correction, unless the correction is described in section 6.02(3) of this revenue procedure;

(5) accept tax return information only from Electronic Filers;

(6) include its SBIN and the ERO's EFIN with all return information the Service Bureau forwards to a Transmitter or sends back to an ERO;

(7) retain each acknowledgement file received from a Transmitter until the end of the calendar year in which the electronic return was filed;

(8) if requested, serve as a contact point between its client EROs and the Service;

(9) if requested, provide the Service with a list of each client ERO; and

(10) ensure against the unauthorized use of its SBIN. A Service Bureau must not transfer its SBIN by sale, merger, loan, gift, or otherwise to another entity.

.16 An Electronic Filer who participates as a Transmitter must:

(1) transmit all electronic returns within three calendar days of receipt;

(2) retrieve the acknowledgement file within two work days of transmission;

(3) match the acknowledgement file to the original transmission file and send the acknowledgement file to the ERO or the Service Bureau (whether or not the ERO or the Service Bureau are related to the Transmitter) within two work days of retrieving the acknowledgement file;

(4) retain an acknowledgement file received from the Service until the end of the calendar year in which the electronic return was filed;

(5) immediately contact the appropriate service center's Electronic Filing Unit for further instructions if an acknowledgement of acceptance for processing has not been received by the Transmitter within two work days of transmission or if a Transmitter receives an acknowledgement for a return that was not transmitted on the designated transmission;

(6) promptly correct any transmission error that causes an electronic transmission to be rejected;

(7) contact the appropriate service center's Electronic Filing Unit for assistance if a return has been rejected after three transmission attempts;

(8) ensure the security of all transmitted data;

(9) ensure against the unauthorized use of its EFIN or ETIN. A Transmitter must not transfer its EFIN or ETIN by sale, merger, loan, gift, or otherwise to another entity; and

(10) not use software that has a Service assigned production password built into the software.

.17 A Transmitter who provides transmission services to other unrelated Electronic Filers must accept electronic returns for transmission to the Service only from accepted Electronic Filers. A Transmitter must include the ERO's EFIN and if applicable, the CPIN on each return that the Transmitter accepts from an ERO. In addition, a Transmitter must also include a Service Bureau's SBIN if a Service Bureau formats the return information.

.18 An Electronic Filer who participates as a Software Developer must:

(1) promptly correct any software error which causes the electronic portion of a return to be rejected;

(2) promptly distribute any software correction;

(3) ensure that any software package that will be used to transmit electronic returns from multiple Electronic Filers has the capability of combining returns from these Electronic Filers into one Service transmission file taking into account the sorting requirements of the Declaration Control Number (DCN);

(4) ensure that no other entity uses the Software Developer's EFIN or ETIN. A Software Developer must not transfer by sale, merger, loan, gift, or otherwise its EFIN or ETIN to another entity; and

(5) not incorporate into its software a Service assigned production password.

.19 An Electronic Filer with a Drop-Off Collection Point is the ERO for that Drop-Off Collection Point. The ERO must clearly display its name at each Drop-Off Collection Point. The Service will hold the ERO responsible for any violation of the advertising standards described in section 12 or any other violation of this revenue procedure that occurs at a Drop-Off Collection Point listed on the ERO's Form 8633. The ERO must also serve as the contact point between the Service and the Drop-Off Collection Point for all correspondence including problem resolution and report evaluation.

.20 In addition to the specific responsibilities described in this section, an Electronic Filer must meet all the requirements in this revenue procedure to retain the privilege of participating in the Form 1040 ELF Program.

SECTION 6. PENALTIES

.01 *Penalties for Disclosure or Use of Information.*

(1) An Electronic Filer, except a Software Developer, is a tax return preparer (Preparer) under the definition of § 301.7216–1(b) of the Regulations on Procedure and Administration. A Preparer is subject to a criminal penalty for unauthorized disclosure or use of tax return information. See § 7216 of the Internal Revenue Code and § 301.7216–1(a). In addition, § 6713 establishes civil penalties for unauthorized disclosure or use of tax return information.

(2) Under § 301.7216–2(h), disclosure of tax return information among accepted Electronic Filers for the purpose of preparing a return is permissible. For example, an ERO may pass on tax return information to a Service Bureau and/or a Transmitter for the purpose of having an electronic return formatted and transmitted to the Service. However, if the tax return information is disclosed or used in any other way, a Service Bureau and/or a Transmitter may be subject to the penalties described in section 6.01(1) of this revenue procedure.

.02 *Other Preparer Penalties.*

(1) Preparer penalties may be asserted against an individual or firm meeting the definition of an income tax return preparer under § 7701(a)(36) and § 301.7701–15. Preparer penalties that may be asserted under appropriate circumstances include, but are not limited to, those set forth in §§ 6694, 6695, and 6713.

(2) Under § 301.7701–15(d), Electronic Return Collectors, Service Bureaus, Transmitters, and Software Developers are not income tax return preparers for the purpose of assessing most preparer penalties as long as their services are limited to "typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund."

(3) If an Electronic Return Collector, Service Bureau, Transmitter, or the product of a Software Developer alters the return information in a nonsubstantive way, this alteration will be considered to come under the "mechanical assistance" exception described in § 301.7701–15(d)(1). A nonsubstantive change is a correction or change limited to a transposition error, misplaced entry, spelling error, or arithmetic correction that falls within the following tolerances:

(a) the amount of "Total tax", "Federal income tax withheld", "Refund", or "Amount you owe" on Form 8453 differs from the corresponding amount on the electronic portion of the tax return by no more than $7;

(b) the amount of "Total income" on Form 8453 differs from the corresponding amount on the electronic portion of the tax return by no more than $25; or

(c) dropping cents and rounding to whole dollars.

(4) If an Electronic Return Collector, Service Bureau, or Transmitter alters the return information in a substantive way, rather than having the taxpayer alter the return, the Electronic Return Collector, Service Bureau, or Transmitter will be considered to be an income tax return preparer for purposes of § 7701(a)(36).

(5) If an Electronic Return Collector, Service Bureau, or Transmitter, or the product of a Software Developer, goes beyond mechanical assistance, any of these parties may be held liable for income tax return preparer penalties. See Rev. Rul. 85–189, 1985–2 C.B. 341 (which describes a situation where a Software Developer was determined to be an income tax return preparer and subject to certain preparer penalties).

.03 *Other Penalties.* In addition to the above specified provisions, the Service reserves the right to assert all appropriate preparer, nonpreparer, and disclosure penalties against an Electronic Filer as warranted under the circumstances.

SECTION 7. FORM 8453, U.S. INDIVIDUAL INCOME TAX DECLARATION FOR ELECTRONIC FILING

.01 P*rocedures for Completing Form 8453.*

(1) Form 8453 must be completed in accordance with the instructions for that form.

(2) The taxpayer(s)'s name, address, social security number(s), tax return information, and direct deposit of refund information in the electronic transmission must be identical to the information on the Form 8453 that the taxpayer(s) signed and provided for submission to the Service.

(3) An Electronic Filer, a financial institution, or any other entity associated with the electronic filing of a taxpayer's return must not put its address in the section reserved for the taxpayer's address on Form 8453 or anywhere in the electronic portion of a return.

(4) Before the electronic portion of the return is transmitted, the taxpayer must verify the information on the electronic portion of the return and on Form 8453, and must sign Form 8453. Both spouses' signatures are required on the Form 8453 prior to the electronic transmission of a joint tax return. The taxpayer may verify the information on the electronic portion of the return by viewing this information on a computer display terminal. A taxpayer need not verify the electronic portion of the return prior to its transmission if the taxpayer provided a completed paper return for filing and the information on the electronic portion is identical to the information provided by the taxpayer.

(5) An Electronic Filer must submit the taxpayer's Form 8453 to the appropriate service center within one work day after the Electronic Filer receives acknowledgment that the electronic portion of the taxpayer's return has been accepted for processing.

(6) If an Electronic Filer functions as an ERO, the Electronic Filer must sign the ERO's Declaration on Form 8453.

(7) If the ERO is also the paid preparer, the ERO must check the "Paid Preparer" box and sign the ERO Declaration on Form 8453.

.02 *Corrections to Form 8453.*

(1) A new Form 8453 is not required for a nonsubstantive change. A nonsubstantive change is limited to a correction that does not exceed the tolerances, described in section 7.02(2) of this revenue procedure for arithmetic errors, a transposition error, a misplaced entry, or a spelling error. The incorrect nonsubstantive information must be neatly lined through on the Form 8453 and the correct data entered next to the lined-through entry. Also, the individual making the correction must initial the correction.

(2) The tolerances for section 7.02(1) of this revenue procedure are:

(a) the amount of "Total income" does not differ from the amount on the electronic tax return by more than $25; or

(b) the amount of "Total tax", "Federal income tax withheld", "Refund", or "Amount you owe" does not differ from the amount on the electronic portion of the tax return by more than $7.

(3) If the ERO makes a substantive change to the electronic portion of the return after Form 8453 has been signed by the taxpayer, but before it is transmitted, the ERO must have all the necessary parties described above sign a new Form 8453 that reflects the corrections before the return is transmitted.

(4) Dropping cents or rounding to whole dollars does not constitute a substantive change or alteration to the return unless the amount differs by more than the above tolerances. All rounding should be accomplished in accordance with the instructions in the Form 1040 tax package.

.03 *Missing Form 8453.* If the Service determines that a Form 8453 is missing, the ERO must provide the Service with a replacement. The ERO must also provide a copy of the Form(s) W–2, W–2G, 1099R, and all other attachments to Form 8453.

.04 *Substitute Form 8453.* If a substitute Form 8453 is used, it must be approved by the Service prior to use. See Rev. Proc. 96–48, 1996–2 C.B. 339.

SECTION 8. INFORMATION AN ELECTRONIC FILER MUST PROVIDE TO THE TAXPAYER

.01 The ERO must furnish the taxpayer with a complete paper copy of the taxpayer's return. However, the copy need not contain the social security number of the paid preparer. See Rev. Rul. 78–317, 1978–2 C.B. 335. A complete copy of a taxpayer's return includes:

(1) Form 8453 and other paper documents that cannot be electronically transmitted; and

(2) a printout of the electronic portion of the return. See section 2.02 of this revenue procedure. The electronic portion of the return can be contained on a replica of an official form or on an unofficial form. However, on an unofficial form, data entries must be referenced to the line numbers on an official form. Also, a printout of the electronic portion of the return does not have to be provided to the taxpayer if the taxpayer provided a completed paper return for electronic filing and the information on the electronic portion of the return is identical to the information provided by the taxpayer.

.02 The ERO must advise the taxpayer to retain a complete copy of the return and any supporting material.

.03 The ERO must advise the taxpayer that an amended return, if needed, must be filed as a paper return and mailed to the service center that would handle the taxpayer's paper return.

.04 The ERO must, upon request, provide the taxpayer with the Declaration Control Number and the date the Service gave notification that the electronic portion of the taxpayer's return was accepted for processing.

.05 The ERO must advise taxpayers that they can call the local IRS TeleTax number to inquire about the status of their tax refund. The ERO should also advise taxpayers to wait at least three weeks from the date the Service accepted the electronic portion of the taxpayer's return for processing before calling the TeleTax number.

.06 If a taxpayer chooses to use an address other than his or her home address on the return, the Electronic Filer must inform the taxpayer that the address on the electronic portion of the return, once

processed by the Service, will be used to update the taxpayer's address of record. The Internal Revenue Service uses the taxpayer's address of record for various notices that are required to be sent to a taxpayer's "last known address" under the Internal Revenue Code, and for refunds of overpayments of tax (unless otherwise specifically directed by the taxpayer, such as by Direct Deposit).

SECTION 9. DIRECT DEPOSIT OF REFUNDS

.01 The Service will ordinarily process a request for Direct Deposit but reserves the right to issue a paper refund check.

.02 The Service does not guarantee a specific date by which a refund will be directly deposited into the taxpayer's financial institution account.

.03 Neither the Service nor Financial Management Service (FMS) is responsible for the misapplication of a Direct Deposit that is caused by error, negligence, or malfeasance on the part of the taxpayer, Electronic Filer, financial institution, or any of their agents.

.04 An ERO must:

(1) advise taxpayers of the option to receive their refund by paper check or direct deposit;

(2) not charge a separate fee for a Direct Deposit;

(3) accept any Direct Deposit election to any eligible

financial institution designated by the taxpayer;

(4) ensure that the taxpayer is eligible to choose Direct Deposit;

(5) verify that the taxpayer has entered the Direct Deposit information requested on Part II of Form 8453 correctly and that the information entered is the information transmitted with the electronic portion of the return;

(6) caution the taxpayer that once an electronic

return has been accepted for processing by the Service:

(a) the Direct Deposit election cannot be rescinded;

(b) the Routing Transit Number (RTN) of the financial institution cannot be changed; and

(c) the taxpayer's account number cannot be changed; and

(7) advise the taxpayer that refund information is available by calling the local IRS TeleTax number. See section 8.05 of this revenue procedure.

SECTION 10. REFUND ANTICIPATION LOANS

.01 A Refund Anticipation Loan (RAL) is money borrowed by a taxpayer that is based on a taxpayer's anticipated income tax refund. The Service has no involvement in RALs. A RAL is a contract between the taxpayer and the lender.

.02 Any entity that is involved in the Form 1040 ELF Program, including a financial institution that accepts direct deposits of income tax refunds, has an obligation to every taxpayer who applies for a RAL to clearly explain to the taxpayer that a RAL is in fact a loan, and not a substitute for or a quicker way of receiving an income tax refund. An Electronic Filer must advise the taxpayer that if a Direct Deposit is not timely, the taxpayer may be liable to the lender for additional interest on the RAL.

.03 An Electronic Filer may assist a taxpayer in applying for a RAL.

.04 An Electronic Filer may charge a flat fee to assist a taxpayer in applying for a RAL. The fee must be identical for all of the Electronic Filer's customers and must not be related to the amount of the refund or a RAL. The Electronic Filer must not accept a fee from a financial institution for any service connected with a RAL that is contingent upon the amount of the refund or a RAL.

.05 The Service has no responsibility for the payment of any fees associated with the preparation of a return, the electronic transmission of a return, or a RAL.

.06 An Electronic Filer may disclose tax information to the lending financial institution in connection with an application for a RAL only with the taxpayer's written consent as specified in § 301.7216–3(b).

.07 An Electronic Filer that is also the return preparer, and the financial institution or other lender that makes an RAL, may not be related taxpayers within the meaning of § 267 or § 707.

.08 Section 6695(f) imposes a $500 penalty on a return preparer who endorses or negotiates a refund check issued to any taxpayer other than the return preparer. However, a bank, as defined in § 581, may accept the full amount of a refund check as a deposit in the taxpayer's account for the benefit of the taxpayer. Section 1.6695–1(f) clarifies § 6695(f) by explaining that the prohibition on a return preparer negotiating a refund check is limited to a refund check for a return that the return preparer prepared. A preparer that is also a financial institution, but has not made a loan to the taxpayer on the basis of the taxpayer's anticipated refund, may (1) cash a refund check and remit all of the cash to the taxpayer or accept a refund check for deposit in full to a taxpayer's account, provided the bank does not initially endorse or negotiate the check; or (2) endorse a refund check for deposit in full to a taxpayer's account pursuant to a written authorization of the taxpayer. A preparer bank may also subsequently endorse or negotiate a refund check as part of the check-clearing process through the financial system after initial endorsement. Any income tax return preparer that violates this provision may be suspended from the Form 1040 ELF Program.

SECTION 11. BALANCE DUE RETURNS

.01 All service centers that accept electronically filed

returns will accept electronically filed balance due returns.

.02 The Electronic Filer must furnish Form 1040-V, Payment Voucher, to a taxpayer who electronically files a balance due return.

.03 To expedite the crediting of a tax payment, a taxpayer who electronically files a balance due return should mail his or her tax payment with either Form 1040-V or the scannable payment voucher that is included in some tax packages. Each of these options has specific mailing instructions.

.04 A taxpayer who electronically files a balance due return must make a full and timely payment of any tax that is due. Failure to make full payment of any tax that is due on or before April 15, 1998, will result in the imposition of interest and may result in the imposition of penalties.

SECTION 12. ADVERTISING STANDARDS FOR ELECTRONIC FILERS AND FINANCIAL INSTITUTIONS

.01 An Electronic Filer shall comply with the advertising and solicitation provi-

sions of 31 C.F.R. Part 10 (Treasury Department Circular No. 230). This circular prohibits the use or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive, or unfair statement or claim. Any claims concerning faster refunds by virtue of electronic filing must be consistent with the language in official Service publications.

.02 An Electronic Filer must adhere to all relevant federal, state, and local consumer protection laws that relate to advertising and soliciting.

.03 An Electronic Filer must not use the Service's name, "Internal Revenue Service" or "IRS", within a firm's name.

.04 An Electronic Filer must not use improper or misleading advertising in relation to the Form 1040 ELF Program (including the time frames for refunds and RALs).

.05 An Electronic Filer using electronic filing promotional materials or logos provided by the Service must comply with all Service instructions pertaining to the promotional materials or logos.

.06 Use of Direct Deposit name and logo.

(1) The name "Direct Deposit" will be used with initial capital letters or all capital letters.

(2) The logo/graphic for Direct Deposit will be used whenever feasible in advertising copy.

(3) The color or size of the Direct Deposit logo/graphic may be changed when used in advertising pieces.

.07 Advertising materials shall not carry the FMS, IRS, or other Treasury Seals.

.08 Advertising for a cooperative electronic return filing project (public/private sector) must clearly state the names of all cooperating parties.

.09 In advertising the availability of a RAL, an Electronic Filer and a financial institution must clearly (and, if applicable, in easily readable print) refer to or describe the funds being advanced as a loan, not a refund; that is, it must be made clear in the advertising that the taxpayer is borrowing against the anticipated refund and not obtaining the refund itself from the financial institution.

.10 If an Electronic Filer uses radio or television broadcasting to advertise, the broadcast must be pre-recorded. The Electronic Filer must keep a copy of the pre-recorded advertisement for a period of at least 36 months from the date of the last transmission or use.

.11 If an Electronic Filer uses direct mail or fax communications to advertise, the Electronic Filer must retain a copy of the actual mailing or fax, along with a list or other description of the firms, organizations, or individuals to whom the communication was mailed, faxed, or otherwise distributed for a period of at least 36 months from the date of the last mailing, fax, or distribution.

.12 Acceptance to participate in the Form 1040 ELF Program does not imply endorsement by the Service, FMS, or the Treasury Department of the software or quality of services provided.

SECTION 13. MONITORING AND SUSPENSION OF AN ELECTRONIC FILER

.01 The Service will monitor an Electronic Filer for conformity with this revenue procedure. Before suspending an Electronic Filer, the Service may issue a warning letter that describes specific corrective action for deviations from this revenue procedure. However, the Service can immediately suspend, without notice, an Electronic Filer from the Form 1040 ELF Program. In most circumstances, a suspension from participation in the Form 1040 ELF Program is effective as of the date of the letter informing the Electronic Filer of the suspension.

.02 If a Principal or Responsible Official is suspended from the Form 1040 ELF Program, every entity that listed the suspended Principal or Responsible Official on its Form 8633 may also be suspended.

.03 The Service will monitor the timely receipt of Forms 8453, as well as their overall legibility.

.04 The Service will monitor the quality of an Electronic Filer's transmissions throughout the filing season. The Service will also monitor the electronic portion of returns and tabulate rejections, errors, and other defects. If quality deteriorates, the Electronic Filer will receive a warning from the Service.

.05 The Service will monitor Drop-Off Collection Points and advise a parent of any Form 1040 ELF Program violations the Service has encountered with a parent's Drop-Off Collection Point. If a parent fails to correct a Drop-Off Collection Point problem, the parent will be required to eliminate that Drop-Off Collection Point. Failure to take corrective action or eliminate a Drop-Off Collection Point may cause the Service to suspend the parent from participating in the Form 1040 ELF Program.

.06 The Service will monitor complaints about an Electronic Filer and issue a warning or suspension letter as appropriate.

.07 The Service reserves the right to suspend an Electronic Filer from participation in the Form 1040 ELF Program for violating any provision of this revenue procedure. Generally, the Service will advise a suspended Electronic Filer concerning the requirements for reacceptance into the Form 1040 ELF Program. The following reasons may lead to a warning letter and/or suspension of an Electronic Filer from the Form 1040 ELF Program (this list is not all-inclusive):

(1) the reasons listed in section 4.19 of this revenue procedure;

(2) deterioration in the format of individual transmissions;

(3) unacceptable cumulative error or rejection rate;

(4) untimely received, illegible, incomplete, missing, or unapproved substitute Forms 8453;

(5) stockpiling returns at any time while participating in the Form 1040 ELF Program;

(6) failure on the part of a Transmitter to retrieve acknowledgement files within two work days of transmission by the Service;

(7) failure on the part of a Transmitter to provide an ERO or Service Bureau with acknowledgement files within two work days after receipt from the Service;

(8) significant complaints about an Electronic Filer's performance in the Form 1040 ELF Program;

(9) failure on the part of an Electronic Filer to ensure against the unauthorized use of its EFIN and/or ETIN;

(10) having more than one EFIN for the same business entity at the same location (the business entity is generally the entity that reports on its return the income derived from electronic filing), unless the Service has issued more than one EFIN to a business entity at the same location. For example, the Service may issue more than one EFIN to accommodate high volumes of returns;

(11) failure on the part of a Transmitter to include a Service Bureau's SBIN in the transmission of a return submitted by a Service Bureau;

(12) failure on the part of an ERO to include a Drop-Off Collection Point's CPIN as part of a return collected from a Drop-Off Collection Point;

(13) failure on the part of an Electronic Filer to cooperate with the Service's efforts to monitor Electronic Filers and investigate electronic filing abuse;

(14) failure on the part of an Electronic Filer to properly use the standard/nonstandard W–2 indicator;

(15) failure on the part of an Electronic Filer to properly use the refund anticipation loan (RAL) indicator;

(16) failure on the part of a Service Bureau or a Transmitter to include the ERO's EFIN as part of a return that the ERO submits to the Service Bureau or the Transmitter;

(17) violation of the advertising standards described in section 12 of this revenue procedure;

(18) failure to maintain and make available records as described in section 5.09(4) of this revenue procedure;

(19) accepting a tax return for electronic filing either directly or indirectly from a firm, organization, or individual (other than the taxpayer who is submitting his or her return) that is not in the Form 1040 ELF Program;

(20) submitting the electronic portion of a return with information that is not identical to the information on Form 8453; or

(21) failure to timely submit a revised Form 8633 (or a letter containing the same information contained in a revised Form 8633) notifying the Service of changes described in section 4.03 or 4.04 of this revenue procedure.

.08 The Service may list in the Internal Revenue Bulletin, district office listings, district office newsletters, and the EFS Bulletin Board the name and owner(s) of any entity suspended from the Form 1040 ELF Program and the effective date of the suspension.

.09 A district director may warn Electronic Filers who are using the services of a rejected or a suspended Electronic Filer that sections 4.19(11) and (12) of this revenue procedure prohibit a business relationship with a rejected or a suspended Electronic Filer. However, in appropriate circumstances, the Service may immediately suspend the Electronic Filer.

.10 If an Electronic Filer is suspended from participating in the Form 1040 ELF Program, the period of suspension includes the remainder of the calendar year in which the suspension occurs plus the next two calendar years. A suspended participant may submit a new application for the application period immediately preceding the end of the suspension.

SECTION 14. ADMINISTRATIVE REVIEW PROCESS FOR DENIAL OF PARTICIPATION IN THE FORM 1040 ELECTRONIC FILING PROGRAM

.01 An applicant that has been denied participation in the Form 1040 ELF Program has the right to an administrative review. During the administrative review process, the denial of participation remains in effect.

.02 In response to the submission of a Form 8633, the Andover Service Center will either (1) accept an applicant into the Form 1040 ELF Program, or (2) issue a proposed letter of denial that explains to the applicant why the service center proposes to reject the application to participate in the Form 1040 ELF Program.

.03 An applicant that receives a proposed letter of denial may mail or deliver, within 30 calendar days of the date of the proposed letter of denial, a written response to the Andover Service Center. The applicant's response must address the service center's reason(s) for proposing the denial to participate.

.04 Upon receipt of an applicant's written response, the Andover Service Center will reconsider its proposed letter of denial. The service center may either (1) withdraw its proposed letter of denial and admit the applicant into the Form 1040 ELF Program, or (2) finalize the proposed denial letter.

.05 If an applicant receives a final denial letter from the Andover Service Center, the applicant is entitled to an appeal, in writing, to the Director of Practice.

.06 The appeal must be mailed or delivered to the Andover Service Center within 30 calendar days of the date of the final denial letter. An applicant's written appeal must contain a detailed explanation, with supporting documentation, of why the denial should be reversed.

.07 The Andover Service Center will, upon receipt of a written appeal to the Director of Practice, forward to the Director of Practice its file on the applicant and the material described in section 14.06 of this revenue procedure. The service center will forward these materials to the Director of Practice within 15 calendar days of receipt of the applicant's written appeal.

.08 Failure to respond within either of the 30-day periods described in sections 14.03 and 14.06 of this revenue procedure irrevocably terminates an applicant's right to an administrative review or appeal.

.09 If an application for participation in the Form 1040 ELF Program is denied, the applicant is ineligible to submit a new application for two years from the application date of the denied application.

SECTION 15. ADMINISTRATIVE REVIEW PROCESS FOR SUSPENSION FROM THE FORM 1040 ELECTRONIC FILING PROGRAM

.01 An Electronic Filer that has been suspended from participation in the Form 1040 ELF Program has the right to an administrative review. During the administrative review process, the suspension remains in effect.

.02 If an Electronic Filer receives a suspension letter, the Electronic Filer may mail or deliver, within 30 calendar days of the date of the suspension letter, a detailed written explanation, with supporting documentation, of why the suspension letter should be withdrawn. This written response should be sent to the district office or service center that issued the suspension letter.

.03 Upon receipt of the Electronic Filer's written response, the district office or service center will reconsider its suspension of the Electronic Filer. The district office or service center may either (1) withdraw its suspension letter, or (2) affirm the suspension.

.04 If an Electronic Filer receives a letter affirming the suspension, the Electronic Filer is entitled to an appeal, in writing, to the Director of Practice.

.05 The appeal must be mailed or delivered to the district office or service

center that issued the suspension letter within 30 calendar days of the date of the letter affirming the suspension. The Electronic Filer's written appeal must contain detailed reasons, with supporting documentation, for reversal of the suspension.

.06 The district office or service center whose decision to suspend is being appealed will, upon receipt of a written appeal to the Director of Practice, forward its file on the Electronic Filer to the Director of Practice. The district office or service center will also forward to the Director of Practice the material described in section 15.05 of this revenue procedure. The district office or the service center will forward these materials within 15 calendar days of the receipt of the Electronic Filer's written request for appeal.

.07 Failure to appeal within either of the 30-day periods described in sections 15.02 and 15.05 of this revenue procedure irrevocably terminates an Electronic Filer's right to an appeal.

SECTION 16. VITA AND TCE SPONSORED ELECTRONIC FILING

.01 This revenue procedure applies to VITA (Volunteer Income Tax Assistance) and TCE (Tax Counseling for the Elderly) sponsors subject to the exceptions and restrictions described in this section.

.02 For purposes of this section, the District Director may be represented by an individual designated by the District Director such as a District Office Electronic Filing Coordinator (DOEFC) or a Taxpayer Education Coordinator.

.03 To be accepted in, or to continue participation in, the Form 1040 ELF Program, a VITA or TCE sponsor must:

(1) have obtained the District Director's permission (and, in the case of a TCE sponsor, the permission of the Service office that is funding the TCE program) to provide electronic filing; and

(2) have a manual or electronic quality review system for each return to be electronically filed.

.04 The District Director will advise the VITA and TCE sponsor how to submit or transmit returns. Some of the options available to the District Director are:

(1) having the VITA or TCE sponsor submit returns on paper, magnetic disk, or in an electronic transmission to the DOEFC or other locally designated office;

(2) having the VITA or TCE sponsor directly transmit returns to the appropriate service center; or

(3) having the VITA or TCE sponsor use a third party Transmitter.

.05 A VITA or TCE sponsor is not required to sign Form 8453 as ERO. However, if the VITA or TCE sponsor chooses not to sign Form 8453, the VITA or TCE sponsor must otherwise furnish on Form 8453 its VITA or TCE acronym and, if operating from multiple sites, a site designation number.

.06 A VITA or TCE sponsor can only accept a return for electronic filing that is (1) prepared at the VITA or TCE site by a VITA or TCE volunteer, (2) prepared by a taxpayer that meets the criteria for VITA or TCE assistance, or (3) prepared by a paid preparer that meets the criteria for VITA or TCE assistance.

.07 Only returns and accompanying forms and schedules included in a district, VITA, or TCE training course may be accepted for electronic filing by a VITA or TCE sponsor.

.08 A VITA or TCE sponsor and a District Director may enter into an agreement that provides for the retention of copies of tax returns and Forms 8453 by a District Director. This information must be retained by either the VITA or TCE sponsor or a District Director. This information must not be given to a third party, including a third party Transmitter.

.09 A District Director is responsible for ensuring that Form 8453 is sent to the appropriate district office or service center. However, a District Director may delegate to the VITA or TCE sponsor the responsibility for mailing Form 8453 to the appropriate district office or service center.

.10 A VITA or TCE sponsor may collect a fee only if it is directly related to defraying the actual cost of electronically transmitting a tax return. A VITA or TCE sponsor may also collect this fee on behalf of a third party Transmitter who electronically transmitted a VITA or TCE return.

.11 Before a VITA or TCE sponsor may collect a fee for electronically filing a tax return, the VITA or TCE sponsor must ensure that the taxpayer understands that:

(1) the fee is not for the preparation of the return; and

(2) the VITA or TCE service is offered without regard to either the electronic filing of a return or the collection of a fee.

SECTION 17. EMPLOYER SPONSORED ELECTRONIC FILING

.01 This revenue procedure applies to an employer who chooses to offer electronic filing as an employee benefit to (1) business owners and spouses, (2) employees and spouses, and/or (3) dependents of business owners and employees, subject to the exceptions and restrictions described in this section.

.02 For purposes of this section, the District Director may be represented by an individual designated by the District Director.

.03 An employer may choose to electronically transmit returns or may arrange to have tax returns electronically transmitted through a third party. If an employer chooses to transmit returns from more than one location, the employer must submit a properly completed Form 8633 for each location.

.04 An employer may offer electronic filing as an employee benefit whether the employer chooses to transmit tax returns or contracts with a third party to transmit the tax returns.

.05 If an employer contracts with a third party to transmit tax returns, the employer may collect from participating employees a fee that is directly related to defraying the actual cost of electronically transmitting a tax return.

.06 An employer is not required to sign Form 8453 as ERO. However, if the employer chooses not to sign Form 8453, the employer must otherwise furnish on Form 8453 its name, address, and the designation "Employee Benefit," and if operating from multiple sites, a site designation number.

.07 An employer and a District Director may enter into an agreement that provides for the retention of copies of tax returns including Forms 8453. In the absence of such an agreement, this information must be retained by the employer. This information is not to be given to a third party, including a third party Transmitter.

SECTION 18. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–61, 1996–2 C.B. 401, is superseded.

SECTION 19. EFFECTIVE DATE

This revenue procedure is effective December 29, 1997.

SECTION 20. INTERNAL REVENUE SERVICE OFFICE CONTACT

All questions regarding this revenue procedure should be directed to the Internal Revenue Service. The telephone number for this purpose is (202) 283-0531 (not a toll-free number).

SECTION 21. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have 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 1545–1512.

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 collections of information in this revenue procedure are in sections 5, 8, 9, and 12. This information is required to implement the Form 1040 ELF Program and to enable taxpayers to file their individual income tax returns electronically. The information will be used to ensure that taxpayers receive accurate and essential information regarding the filing of their electronic returns and to identify the persons involved in the filing of electronic returns. The collections of information are required to retain the benefit of participating in the Form 1040 ELF Program. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and recordkeeping burden is 1,146,272 hours.

The estimated annual burden per respondent/recordkeeper varies from six (6) minutes to 15.5 hours, depending on individual circumstances, with an estimated average of 15.28 hours (or approximately six (6) minutes per electronically filed return). The estimated number of respondents and recordkeepers is 75,000.

The estimated annual frequency of responses is on occasion.

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

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26 CFR 601.602: Tax forms and instructions. (Also Part I, sections 6012, 6061; 1.6012-5, 1.6061–1)

Rev. Proc. 97–61

CONTENTS

SECTION 1. PURPOSE

This revenue procedure informs those who participate in the Form 1040 On-Line Filing Program of their obligations to the Internal Revenue Service, taxpayers, and other participants. The following returns can be filed under the Form 1040 On-Line Filing Program: (1) 1997 Form 1040 and 1997 Form 1040A, U.S. Individual Income Tax Return; and (2) 1997 Form 1040EZ, Income Tax Return for Single and Joint Filers With No Dependents. This revenue procedure updates and supersedes Rev. Proc. 96–62, 1996-2 C.B. 412.

SECTION 2. BACKGROUND AND CHANGES

.01 Section 1.6012–5 of the Income Tax Regulations provides that the Commissioner may authorize the use, at the option of a person required to make a return, of a composite return in lieu of any form specified in 26 C.F.R. Part 1 (Income Tax), subject to the conditions, limitations, and special rules governing the preparation, execution, filing, and correction thereof as the Commissioner may deem appropriate.

.02 For purposes of this revenue procedure, an on-line electronically filed Form 1040, Form 1040A, or Form 1040EZ is a composite return consisting of electronically transmitted data and certain paper documents. The paper portion of the return consists of Form 8453–OL, U.S. Individual Income Tax Declaration for On-Line Filing, and other paper documents that cannot be electronically transmitted. Form 8453–OL must be received by the Service before the composite return is considered filed (see section 5.07 of this revenue procedure). The composite return must contain the same information that a return filed completely on paper

contains. See section 7 of this revenue procedure for procedures for completing Form 8453–OL.

.03 The Service will periodically issue Publication 1345, Handbook for Electronic Filers of Individual Income Tax Returns, that lists the forms and schedules associated with the Form 1040 series that can be electronically transmitted.

.04 For the purposes of the Form 1040 On-Line Filing Program, a 1997 Form 1040, Form 1040A, or Form 1040EZ cannot be electronically filed after October 15, 1998, notwithstanding the fact that the taxpayer has been granted an extension to file a return beyond that date.

.05 An amended tax return cannot be electronically filed under the Form 1040 On-Line Filing Program. A taxpayer must file an amended tax return on paper in accordance with the instructions for Form 1040X, Amended U.S. Individual Income Tax Return.

.06 A tax return that has a foreign address for the taxpayer cannot be electronically filed under the Form 1040 On-Line Filing Program. Army/Air Force (APO) and Fleet (FPO) post offices are not considered foreign addresses.

.07 A tax return for a decedent cannot be electronically filed under the Form 1040 On-Line Filing Program. The decedent's spouse or personal representative must file a paper tax return for the decedent.

.08 This revenue procedure updates and supersedes Rev. Proc. 96–62, 1996–2 C.B. 412. The updates include changes in the Form 1040 On-Line Filing Program, clarification of prior Form 1040 On-Line Filing Program statements, and additional guidance derived from other Service documents that relate to the Form 1040 On-Line Filing Program. Some of the updates are:

(1) Unless certain changes listed in sections 4.03 and 4.04 of this revenue procedure have occurred, an On-Line Filer that actively participated in the most recent Form 1040 On-Line Filing Program does not have to reapply to participate in the Form 1040 On-Line Filing Program (section 4.01);

(2) the application period for the Form 1040 On-Line Filing Program runs from September 2, 1997, through December 1, 1997 (section 4.05);

(3) all applications for the Form 1040 On-Line Filing Program must be sent to the Andover Service Center (sections 4.07 and 5.05);

(4) Applicants and certain On-Line Filers must submit information to the IRS Headquarters Form 1040 On-Line Filing Program Analyst by December 31, 1997 (sections 4.08 and 4.09);

(5) an individual who is an attorney may submit evidence of professional status in lieu of a fingerprint card provided the individual is not currently under suspension or disbarment from practice before the Service or the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia (section 4.12(1));

(6) an individual who is a certified public accountant may submit evidence of professional status in lieu of a fingerprint card provided the individual is not currently under suspension or disbarment from practice before the Service, or whose license to practice is not currently suspended or revoked by any State, Commonwealth, possession, territory, or the District of Columbia (section 4.12(2);

(7) timely notification that an On-Line Filer has discontinued participation in the Form 1040 On-Line Filing Program must be sent to the Andover Service Center (section 5.06);

(8) a Transmitter must ensure that it does not use an EFIN or ETIN obtained through the Form 1040 Electronic Filing (ELF) Program in a transmission of the electronic portion of a taxpayer's return as part of the Form 1040 On-Line Filing Program (section 5.15); and

(9) the Andover Service Center is the office responsible for accepting or rejecting an application to participate in the Form 1040 On-Line Filing Program (sections 13.02 through 13.07).

SECTION 3. ON-LINE FILING PARTICIPANTS—DEFINITIONS

.01 After acceptance into the Form 1040 On-Line Filing Program, as described in section 4 of this revenue procedure, a participant is referred to as an "On-Line Filer."

.02 The On-Line Filer categories are:

(1) ON-LINE SERVICE PROVIDER. An "On-Line Service Provider" is an online information service organization that provides paying subscribers (individuals who use the various services offered by an On-Line Service Provider) dial-up access to a variety of data bases. For purposes of the Form 1040 On-Line Filing Program, an On-Line Service Provider must also have:

(a) an established subscriber or client base to whom the On-Line Service Provider offers services on a continuing basis and about which the On-Line Service Provider maintains certain minimum information identifying the subscriber. Such information could include the subscriber's name, account number, or credit card or demand deposit account number;

(b) a port capacity of at least 1,000 lines or the ability to simultaneously service 1,000 customers;

(c) a network of personal computers that are linked by modems;

(d) access to a broad spectrum of information and/or entertainment services; and

(e) a client base that has the ability to communicate using electronic mail.

(2) SOFTWARE DEVELOPER. A "Software Developer" develops software for the purposes of (a) formatting returns according to the Service's electronic return specifications; and/or (b) transmitting electronic returns directly to the Service. A Software Developer may also sell its software.

(3) TRANSMITTER. A "Transmitter" transmits the electronic portion of a return directly to the Service. An entity that provides a "bump-up" service is a Transmitter. A "bump-up" service provider increases the transmission rate or line speed of formatted or reformatted information that is being sent to the Service via a public switched telephone network. The Service accepts both asynchronous and bisynchronous communications protocols.

.03 The On-Line Filer categories are not mutually exclusive. For example, a Software Developer can, at the same time, be considered a Transmitter or an On-Line Service Provider depending on the function(s) performed.

SECTION 4. ACCEPTANCE IN THE FORM 1040 ON-LINE FILING PROGRAM

.01 Except as provided in sections 4.02 through 4.04 of this revenue procedure, an On-Line Filer that has actively participated in the most recent Form 1040 On-Line Filing Program does not have to reapply to participate in the Form 1040

On-Line Filing Program. However, an On-Line Filer that intends to participate as a Transmitter or a Software Developer in the Form 1040 On-Line Filing Program must first successfully complete the testing referred to in section 4.10 of this revenue procedure. In addition, section 4.13 of this revenue procedure provides for the Service's issuance of credentials necessary for participation in the Form 1040 On-Line Filing Program.

.02 Applicants must file a new Form 8633, Application to Participate in the Electronic Filing Program, (hereinafter "Form 8633"), with completed fingerprint cards for the appropriate individuals, if:

(1) the applicant has never participated in the Form 1040 On-Line Filing Program;

(2) the applicant has previously been denied participation in the Form 1040 On-Line Filing Program; or

(3) the applicant has been suspended from the Form 1040 On-Line Filing Program.

Applicants must designate that the Form 8633 is for the Form 1040 On-Line Filing Program by putting the words "ON-LINE FILING PROGRAM" across the top of the form and the letters "OLF" in the box in the upper left hand corner of the form that indicates whether the form is new or revised.

.03 To participate in the Form 1040 On-Line Filing Program, an On-Line Filer in the most recent Form 1040 On-Line Filing Program must submit a revised Form 8633 (designated for the Form 1040 On-Line Filing Program as described in section 4.02 of this revenue procedure), signed by all "Principals" and the "Responsible Official" (as described in section 4.11 of this revenue procedure) with completed fingerprint cards for the appropriate individuals if:

(1) the On-Line Filer functioned solely as a Software Developer during the most recent Form 1040 On-Line Filing Program and intends to function as an On-Line Service Provider or Transmitter during the Form 1040 On-Line Filing Program;

(2) there is an additional Principal, such as a partner or a corporate officer, that must be listed on Form 8633, line 8, "Principals of Your Firm or Organization";

(3) there is a Principal listed on Form 8633, line 8, that should be deleted; or

(4) the Responsible Official on Form 8633, line 9 changes.

.04 Except as provided in section 4.03 of this revenue procedure, to participate in the Form 1040 On-Line Filing Program, an On-Line Filer in the most recent Form 1040 On-Line Filing Program must submit either a revised Form 8633, or a letter containing the same information contained in a revised Form 8633, if any information on the On-Line Filer's Form 8633 has changed. A revised Form 8633 or letter submitted under this section should include only the information requested on lines 1a through 1i of Form 8633 and the information being revised. A Principal or a Responsible Official must sign the revised Form 8633 or the letter.

.05 For applicants described in section 4.02 of this revenue procedure, the application period runs from September 2, 1997, through December 1, 1997.

.06 Revised applications described in sections 4.03 and 4.04 of this revenue procedure must be submitted within 30 days of the change(s) reflected on the revised Form 8633 or in the letter.

.07 Applicants and On-Line Filers described in sections 4.02 through 4.04 of this revenue procedure must file Form 8633 (or a letter as provided in section 4.04 of this revenue procedure) with the Andover Service Center.

.08 Applicants described in section 4.02 must submit the following information (or the name and phone number of an individual who can provide the information) to the IRS Headquarters Form 1040 On-Line Filing Program Analyst (see section 17 of this revenue procedure) by December 31, 1997:

(1) the brand name of the software the applicant will be using, has developed, or will be transmitting, and the following information regarding the software:

(a) the name of the Software Developer for the software;

(b) the name of the Transmitter for the software;

(c) the retail cost of the software and any additional costs for transmitting the electronic portion of the taxpayer's return;

(d) whether the software can be used to file Federal/State returns;

(e) whether the software is available on the Internet and, if so, the Internet address;

(f) the Professional Package name of the software submitted for Participants Acceptance Testing (PATS) and whether the software has successfully completed PATS;

(2) the applicant's point of contact for matters relating to the Form 1040 On-Line Filing Program and the telephone number for the point of contact; and

(3) the applicant's customer service telephone number.

.09 On-Line Filers that participated in the most recent Form 1040 On-Line Filing Program must submit any changes to the information contained in sections 4.08(1) through (3) of this revenue procedure to the IRS Headquarters Form 1040 On-Line Filing Program Analyst by December 31, 1997.

.10 Applicants and On-Line Filers described in sections 4.01 through 4.04 of this revenue procedure that intend to participate as a Transmitter or a Software Developer in the Form 1040 On-Line Filing Program must first successfully complete the necessary testing at the appropriate service center(s).

.11 Each individual listed as a Principal or a Responsible Official must:

(1) be a United States citizen or an alien lawfully admitted for permanent residence as described in 8 U.S.C. § 1101(a)-(20) (1994);

(2) have attained the age of 21 as of the date of application;

(3) submit with Form 8633 one standard fingerprint card with a full set of fingerprints taken by a law enforcement agency, except as provided in section 4.12 of this revenue procedure; and

(4) pass a suitability check that includes a credit check, a tax compliance check, and a fingerprint check.

.12 An individual may choose to submit evidence of the individual's professional status in lieu of a standard fingerprint card if the individual is:

(1) an attorney in good standing of the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia, and is not currently under suspension or disbarment from practice before the Service or the bar of the highest court of any State, Commonwealth, possession, territory, or the District of Columbia;

(2) a certified public accountant who is duly qualified to practice as a certified public accountant in any State, Common-

wealth, possession, territory, or the District of Columbia, and is not currently under suspension or disbarment from practice before the Service or whose license to practice is not currently suspended or revoked by any State, Commonwealth, possession, territory, or the District of Columbia;

(3) an enrolled agent pursuant to part 10 of 31 C.F.R. Subtitle A;

(4) an officer of a publicly held corporation; or

(5) a banking official who is bonded and has been fingerprinted within the last two years.

.13 The Service will issue credentials to eligible applicants for the Form 1040 On-Line Filing Program, as well as On-Line Filers that do not have to reapply pursuant to section 4.01, 4.03, or 4.04 of this revenue procedure (provided they have first satisfactorily completed the testing described in section 4.10 of this revenue procedure if they intend to participate as a Transmitter or Software Developer). No one may participate in the Form 1040 On-Line Filing Program without the following credentials:

(1) a letter of acceptance into the Form 1040 On-Line Filing Program;

(2) an Electronic Filing Identification Number (EFIN) for each applicable service center; and

(3) if appropriate, an Electronic Transmitter Identification Number (ETIN) for each applicable service center.

.14 If an On-Line Filer is a Software Developer that performs no other function in the Form 1040 On-Line Filing Program but software development, no Principal or Responsible Official needs to pass a suitability check.

.15 The Service may reject an application to participate in the Form 1040 On-Line Filing Program for the following reasons (this list is not all-inclusive). These reason apply to any firm, organization, Principal, or Responsible Official listed on Form 8633:

(1) conviction of any criminal offense under the revenue laws of the United States, or of any offense involving dishonesty or breach of trust;

(2) failure to file timely and accurate tax returns, including returns indicating that no tax is due;

(3) failure to timely pay any tax liabilities;

(4) assessment of tax penalties;

(5) suspension/disbarment from practice before the Service;

(6) disreputable conduct or other facts that would reflect adversely on the Form 1040 On-Line Filing Program;

(7) misrepresentation on an application;

(8) suspension or rejection from either the Form 1040 On-Line Filing Program or the Form 1040 Electronic Filing (ELF) Program in a prior year;

(9) unethical practices in return preparation;

(10) stockpiling returns prior to official acceptance into the Form 1040 On-Line Filing Program (see section 5.21 of this revenue procedure);

(11) knowingly and directly or indirectly employing or accepting assistance from any firm, organization, or individual that is prohibited from applying to participate in the Form 1040 On-Line Filing Program or the Form 1040 ELF Program, or that is suspended from participating in the Form 1040 On-Line Filing Program or the Form 1040 ELF Program. This includes any individual whose actions resulted in the rejection or suspension of a corporation or a partnership from the Form 1040 On-Line Filing Program or the Form 1040 ELF Program; or

(12) knowingly and directly or indirectly accepting employment as an associate, correspondent, or as a subagent from, or sharing fees with, any firm, organization, or individual that is prohibited from applying to participate in the Form 1040 On-Line Filing Program or the Form 1040 ELF Program, or that is suspended from participating in the Form 1040 On-Line Filing Program or the Form 1040 ELF Program. This includes any individual whose actions resulted in the rejection or suspension of a corporation or a partnership from the Form 1040 On-Line Filing Program or the Form 1040 ELF Program.

SECTION 5. RESPONSIBILITIES OF AN ON-LINE FILER

.01 To ensure that complete returns are accurately and efficiently filed, an On-Line Filer must comply with all the publications and notices of the Service relating to electronic filing. Currently, these publications and notices include:

(1) Publication 1345, Handbook for Electronic Filers of Individual Income Tax Returns, and Publication 1345A, Handbook for Electronic Filers of Individual Income Tax Returns (Supplement);

(2) Publication 1346, Electronic Return File Specifications and Record Layouts for Individual Income Tax Returns;

(3) Publication 1436, Test Package for Electronic Filing of Individual Income Tax Returns; and

(4) Postings to the Electronic Filing System Bulletin Board (EFS Bulletin Board).

.02 An On-Line Filer must maintain a high degree of integrity, compliance, and accuracy.

.03 An On-Line Filer may accept returns for on-line electronic filing only from taxpayers or from another On-Line Filer.

.04 If an On-Line Filer charges a fee for the electronic transmission of a tax return, the fee may not be based on a percentage of the refund amount or any other amount from the tax return.

.05 An On-Line Filer must submit a revised Form 8633 (or a letter as provided in section 4.04 of this revenue procedure) to the Andover Service Center within 30 days of when any of the conditions or changes described in section 4.03 or 4.04 of this revenue procedure occur. See section 4.06 of this revenue procedure.

.06 An On-Line Filer must notify the Andover Service Center within 30 days of discontinuing its participation in the Form 1040 On-Line Filing Program. This does not preclude reapplication in the future.

.07 An On-Line Filer must ensure that it promptly processes returns submitted to it for electronic filing. See sections 5.09, 5.10, and 5.11 of this revenue procedure. However, an On-Line Filer that receives a return for electronic filing on or before the due date of the return must ensure that the on-line electronic return is filed on or before that due date (including extensions). An on-line electronic return is not considered filed until the electronic portion of the tax return has been acknowledged by the Service as accepted for processing and a completed and signed Form 8453–OL has been received by the Service. However, if the electronic portion of a return is successfully transmitted on or shortly before the due date and the taxpayer complies with section 7.01 of this revenue procedure, the return will be deemed timely filed. If the electronic portion of a return is transmitted on or

shortly before the due date and is ultimately rejected, but the taxpayer complies with section 5.18 of this revenue procedure, the return will be deemed timely filed. For a balance due return, see section 10 of this revenue procedure for instructions on how to make a timely payment of tax.

.08 An On-Line Filer must ensure against the unauthorized use of its EFIN or ETIN. An On-Line Filer must not transfer its EFIN or ETIN by sale, loan, gift, or otherwise to another entity.

.09 An On-Line Filer that participates as an On-Line Service Provider must:

(1) provide assistance to a subscriber in transmitting the electronic portion of a tax return;

(2) ensure that no more than three tax returns are filed electronically by one subscriber;

(3) not provide to a subscriber software that has a Service-assigned production password built into the software;

(4) immediately send to a subscriber the information provided by a Transmitter under section 5.17 or 5.18 of this revenue procedure; and

(5) inform a subscriber upon request that information regarding a refund can be obtained by using the IRS TeleTax system.

.10 An On-Line Filer that participates as a Software Developer must:

(1) promptly correct any software error which causes the electronic portion of a return to be rejected;

(2) promptly distribute any software correction;

(3) ensure that its software package cannot be used to transmit more than three electronic returns;

(4) ensure that its software package contains a Form 8453–OL format that can be printed and used by a taxpayer to file with the Service;

(5) ensure that its software package contains a consent to disclosure statement; and

(6) not incorporate into its software a Service-assigned production password.

.11 An On-Line Filer that participates as a Transmitter must:

(1) assign (as prescribed in Publication 1345) a Declaration Control Number (DCN) to the electronic portion of each return received from a taxpayer;

(2) include the assigned DCN in the transmission of the electronic portion of a return;

(3) transmit all electronic returns within three calendar days of receipt to the appropriate service center based on the state code in the taxpayer's return address;

(4) retrieve the acknowledgement file (in which the Service states whether it accepts or rejects the electronic portion of a taxpayer's return) within two work days of transmission;

(5) match the acknowledgement file to the original transmission file and notify the taxpayer of the status of a transmitted return as prescribed in section 5.18 of this revenue procedure;

(6) retain, until the end of the calendar year in which a return was filed, the acknowledgement file received from the Service;

(7) retain, until the end of the calendar year in which a return was filed, the complete copy of the electronic portion of the return (may be retained on magnetic media) that can be readily and accurately converted into an electronic transmission that the Service can process;

(8) immediately contact the Electronic Filing Unit at the appropriate service center for further instructions if an acknowledgement of acceptance for processing has not been received by the Transmitter within two work days of transmission or if the Transmitter receives an acknowledgement for a return that was not transmitted on the designated transmission;

(9) promptly correct any transmission error that causes an electronic transmission to be rejected;

(10) contact the Electronic Filing Unit at the appropriate service center for assistance if a return has been rejected after three transmission attempts;

(11) ensure the security of all transmitted data;

(12) ensure that it does not transmit or accept for transmission more than three electronic returns originating from one software package;

(13) ensure that the electronic portion of a return contains a completed consent to disclosure statement; and

(14) ensure that it does not use software that has a Service-assigned production password built into the software.

.12 A Transmitter must include an On-Line Service Provider's EFIN on each return that the Transmitter accepts from an On-Line Service Provider.

.13 A Transmitter must enter the letter "O" in Field #15 (Transmission Type Code) when transmitting the electronic portion of an on-line electronically filed return to the Service. See Part II, Section 1, page 4, of Publication 1346.

.14 A Transmitter must ensure that it does not combine the electronic portion of an on-line electronically filed return with the electronic portion of any other return within the same transmission to the Service.

.15 A Transmitter must ensure that it does not use an EFIN or ETIN obtained through the Form 1040 ELF Program in a transmission of the electronic portion of a taxpayer's return as part of the Form 1040 On-Line Filing Program.

.16 If the Service accepts the electronic portion of a taxpayer's return, the Transmitter must notify the taxpayer (as prescribed in section 5.19 of this revenue procedure) of the following:

(1) the date the transmission was accepted;

(2) the DCN;

(3) where to put the DCN on Form 8453–OL;

(4) the requirement to properly complete and timely submit a Form 8453–OL with accompanying paper documents (including Form W–2, Wage and Tax Statement) within one work day;

(5) the appropriate service center's address to which Form 8453–OL with accompanying paper documents must be sent;

(6) that a Form 8453–OL must be received by the Service before an on-line electronically filed return is complete; and

(7) that the taxpayer's failure to timely submit a Form 8453-OL with accompanying paper documents could result in the Service not allowing the taxpayer to file a tax return through the Form 1040 On-Line Filing Program in the future.

.17 If the Service informs the Transmitter (in an acknowledgement file) that the electronic portion of a taxpayer's return has been rejected, the Transmitter must notify the taxpayer, as prescribed in section 5.19 of this revenue procedure, of the following:

(1) that the Service rejected the electronic portion of the taxpayer's return;

(2) the date of the rejection;

(3) what the reject code(s) means;

(4) what steps the taxpayer needs to take to correct the error that caused the rejection; and

(5) the information contained in section 5.18 of this revenue procedure.

.18 If the taxpayer chooses not to have the electronic portion of the return corrected and transmitted to the Service, or if the electronic portion of the return cannot be accepted for processing by the Service, the taxpayer, in order to file a timely return, must file a paper return by the later of:

(1) the due date of the return; or

(2) ten calendar days after the date the Service gives notification that the electronic portion of the return is rejected or that the electronic portion of the return cannot be accepted for processing.

The paper return should include an explanation of why the return is being filed after the due date.

.19 A Transmitter that transmits a return of a taxpayer who is a subscriber of an On-Line Service Provider must notify the taxpayer by sending an electronic transmission to the On-Line Service Provider within two work days of retrieving the acknowledgement file. A Transmitter that transmits a return of a taxpayer who is not a subscriber of an On-Line Service Provider must notify the taxpayer by:

(1) sending an electronic transmission to the taxpayer within two work days of retrieving the acknowledgement file; or

(2) mailing a written notification to the taxpayer within one work day of retrieving the acknowledgement file.

.20 A Transmitter must make available to the Service upon request all items required by this section to be retained until the end of the calendar year in which a return was filed. The Transmitter must make this material available either at the business address of the Transmitter or from the contact representative named on Form 8633.

.21 A Transmitter is responsible for ensuring that stockpiling does not occur. Stockpiling means collecting returns from taxpayers prior to official acceptance into the Form 1040 On-Line Filing Program, or, after official acceptance into the Form 1040 On-Line Filing Program, waiting more than three calendar days to transmit a return to the Service after receiving the information necessary for an electronic transmission of a tax return.

.22 An On-Line Filer may not offer, nor in any way participate in or facilitate, a Refund Anticipation Loan (RAL) in connection with any return filed under the Form 1040 On-Line Filing Program. A RAL is money borrowed by a taxpayer that is based on a taxpayer's anticipated income tax refund.

.23 An On-Line Filer may not charge a separate fee for a Direct Deposit. See section 9 of this revenue procedure.

.24 In addition to the specific responsibilities described in this section, an On-Line Filer must meet all the requirements in this revenue procedure to keep the privilege of participating in the Form 1040 On-Line Filing Program.

SECTION 6. PENALTIES

.01 *Penalties for Disclosure or Use of Information.*

(1) An On-Line Filer, except a Software Developer that performs no other function in the Form 1040 On-Line Filing Program but software development, is a tax return preparer (Preparer) under the definition of § 301.7216–1(b) of the Regulations on Procedure and Administration. A Preparer is subject to a criminal penalty for unauthorized disclosure or use of tax return information. See § 7216 of the Internal Revenue Code and

§ 301.7216–1(a). In addition, § 6713 establishes civil penalties for unauthorized disclosure or use of tax return information.

(2) Under § 301.7216–2(h), disclosure of tax return information among accepted On-Line Filers for the purpose of preparing a return is permissible. For example, an On-Line Service Provider may pass on tax return information to a Transmitter for the purpose of having an on-line electronic return formatted and transmitted to the Service. However, if the tax return information is disclosed or used in any other way, an On-Line Filer may be subject to the penalties described in section 6.01(1) of this revenue procedure.

.02 *Other Preparer Penalties.*

(1) Preparer penalties may be asserted against an individual or firm meeting the definition of an income tax return preparer under § 7701(a)(36) and § 301.7701–15. Preparer penalties that may be asserted under appropriate circumstances include, but are not limited to, those set forth in §§ 6694, 6695, and 6713.

(2) Under § 301.7701–15(d), an On-Line Filer is not an income tax return preparer for the purpose of assessing most preparer penalties as long as the On-Line Filer's services are limited to "typing, reproduction, or other mechanical assistance in the preparation of a return or claim for refund."

(3) If an On-Line Filer alters the return information in a nonsubstantive way, this alteration will be considered to come under the "mechanical assistance" exception described in § 301.7701–15(d)(1). A nonsubstantive change is a correction or change limited to a transposition error, misplaced entry, spelling error, or arithmetic correction that falls within the following tolerances:

(a) the amount of "Total tax", "Federal income tax withheld", "Refund", or "Amount you owe" on Form 8453–OL differs from the corresponding amount on the electronic portion of the tax return by no more than $7;

(b) the amount of "Total income" shown on Form 8453–OL differs from the corresponding amount on the electronic portion of the tax return by no more than $25; or

(c) dropping cents and rounding to whole dollars.

(4) If an On-Line Filer alters the return information in a substantive way, rather than having the taxpayer alter the return, the On-Line Filer will be considered to be an income tax return preparer for purposes of § 7701(a)(36).

(5) If an On-Line Filer goes beyond mechanical assistance, the On-Line Filer may be held liable for income tax return preparer penalties. See Rev. Rul. 85–189, 1985–2 C.B. 341 (which describes a situation where a Software Developer was determined to be an income tax return preparer and subject to certain preparer penalties).

.03 *Other Penalties.* In addition to the above specified provisions, the Service reserves the right to assert all appropriate preparer, nonpreparer, and disclosure penalties against an On-Line Filer as warranted under the circumstances.

SECTION 7. FORM 8453–OL, U.S. INDIVIDUAL INCOME TAX DECLARATION FOR ON-LINE FILING

.01 *Procedures for Completing Form 8453–OL.*

(1) Form 8453–OL must be completed by the taxpayer in accordance with the instructions for that form.

(2) The taxpayer(s)'s name, address, social security number(s), tax return information, and direct deposit of refund information in the electronic transmission must be identical to the information on the Form 8453–OL that the taxpayer(s) signs and will mail to the appropriate service center.

(3) If the electronic portion of a return was filed as a joint return, both spouses' signatures are required on Form 8453–OL.

(4) The taxpayer's Form 8453–OL must be sent to the address of the appropriate service center within one work day after the taxpayer is provided notification that the electronic portion of the taxpayer's return has been accepted for processing.

.02 *Missing Form 8453–OL.* If the Service determines that a Form 8453–OL is missing, the taxpayer must provide the Service with a replacement. A taxpayer must also provide a copy of any Form W–2, Wage and Tax Statement, Form W–2G, Certain Gambling Winnings, Form 1099–R, Distributions From Pensions, Annuities, Retirement or Profit-Sharing Plans, IRAs, Insurance Contracts, etc., and all other attachments to Form 8453–OL.

.03 *Substitute Form 8453–OL.* If a substitute Form 8453–OL is used, it must be approved by the Service prior to use. See Rev. Proc. 96–48, 1996–2 C.B. 339.

SECTION 8. INFORMATION AN ON-LINE FILER MUST PROVIDE TO THE TAXPAYER

01 The Transmitter must advise a taxpayer to retain a complete copy of the return and any supporting material.

.02 The Transmitter must advise the taxpayer that an amended return, if needed, must be filed as a paper return and mailed to the service center that would handle the taxpayer's paper return.

.03 The Transmitter must give the taxpayer the Declaration Control Number (DCN) for the taxpayer's Form 8453–OL and instructions to the taxpayer for entering the DCN on Form 8453–OL.

.04 If a taxpayer inquires about the status of a refund, the Transmitter, or On-Line Service Provider if the taxpayer is a subscriber, must advise the taxpayer that the taxpayer can call the local IRS TeleTax number to inquire about the status of the taxpayer's refund. The Transmitter or On-Line Service Provider should also advise the taxpayer to wait at least three weeks from the date the Service gave notification that the electronic portion of the taxpayer's return was accepted for processing before calling the TeleTax number.

.05 The Transmitter must inform the taxpayer that the address on the electronic portion of the return, once processed, will be used to update the taxpayer's address of record. The Internal Revenue Service uses the taxpayer's address of record for various notices that are required to be sent to a taxpayer's "last known address" under the Internal Revenue Code and for refunds of overpayments of tax (unless otherwise specifically directed by the taxpayer, such as by Direct Deposit).

SECTION 9. DIRECT DEPOSIT OF REFUNDS

.01 The Service will ordinarily process a request for Direct Deposit but reserves the right to issue a paper refund check.

.02 The Service does not guarantee a specific date by which a refund will be directly deposited into the taxpayer's financial institution account.

.03 Neither the Service nor Financial Management Service (FMS) is responsible for the misapplication of a Direct Deposit that is caused by error, negligence, or malfeasance on the part of the taxpayer, On-Line Filer, financial institution, or any of their agents.

SECTION 10. BALANCE DUE RETURNS

.01 An on-line electronically filed balance due return is transmitted to the appropriate service center in the same manner that a refund or zero balance return is filed. A balance due return is not complete unless and until the Service receives Form 8453–OL completed and signed by the taxpayer.

.02 The Transmitter must furnish Form 1040–V, Payment Voucher, to a taxpayer who electronically files a balance due return.

.03 To expedite the crediting of a tax payment, a taxpayer who electronically files a balance due return should mail his or her tax payment with either Form 1040–V or the scannable payment voucher that is included in some tax packages. Each of these options has specific mailing instructions.

.04 A taxpayer who electronically files a balance due return must make a full and timely payment of any tax that is due. Failure to make full payment of any tax that is due on or before April 15, 1998, will result in the imposition of interest and may result in the imposition of penalties.

SECTION 11. ADVERTISING STANDARDS FOR ON-LINE FILERS

.01 An On-Line Filer shall comply with the advertising and solicitation provisions of 31 C.F.R. Part 10 (Treasury Department Circular No. 230). This circular prohibits the use or participation in the use of any form of public communication containing a false, fraudulent, misleading, deceptive, unduly influencing, coercive, or unfair statement or claim. Any claims concerning faster refunds by virtue of electronic filing must be consistent with the language in official Service publications.

.02 An On-Line Filer must adhere to all relevant federal, state, and local consumer protection laws that relate to advertising and soliciting.

.03 An On-Line Filer must not use the Service's name, "Internal Revenue Service" or "IRS", within a firm's name.

.04 An On-Line Filer must not use improper or misleading advertising in relation to the Form 1040 On-Line Filing Program (including the time frames for refunds).

.05 An On-Line Filer using electronic filing promotional materials or logos provided by the Service must comply with all Service instructions pertaining to the promotional materials or logos.

.06 Use of Direct Deposit name and logo.

(1) The name "Direct Deposit" will be used with initial capital letters or all capital letters.

(2) The logo/graphic for Direct Deposit will be used whenever feasible in advertising copy.

(3) The color or size of the Direct Deposit logo/graphic may be changed when used in advertising pieces.

.07 Advertising materials shall not carry the FMS, IRS, or other Treasury Seals.

.08 Advertising for a cooperative electronic return filing project (public/private sector) must clearly state the names of all cooperating parties.

.09 If an On-Line Filer uses radio or television broadcasting to advertise, the broadcast must be pre-recorded. The On-Line Filer must keep a copy of the pre-recorded advertisement for a period of at least 36 months from the date of the last transmission or use.

.10 If an On-Line Filer uses direct mail or fax communications to advertise, the On-Line Filer must retain a copy of the actual mailing or fax, along with a list or other description of firms, organizations, or individuals to whom the communication was mailed, faxed, or otherwise distributed for a period of at least 36 months from the date of the last mailing, fax, or distribution.

.11 Acceptance to participate in the Form 1040 On-Line Filing Program does not imply endorsement by the Service, FMS, or the Treasury Department of the software or quality of services provided.

SECTION 12. MONITORING AND SUSPENSION OF AN ON-LINE FILER

.01 The Service will monitor an On-Line Filer for conformity with this revenue procedure. Before suspending an On-Line Filer, the Service may issue a warning letter that describes specific corrective action for deviations from this revenue procedure. However, the Service can immediately suspend, without notice, an On-Line Filer from the Form 1040 On-Line Filing Program. In most circumstances, a suspension from participation in the Form 1040 On-Line Filing Program is effective as of the date of the letter informing the On-Line Filer of the suspension.

.02 If a Principal or Responsible Official is suspended from the Form 1040 On-Line Filing Program, every entity that listed the suspended Principal or Responsible Official on its Form 8633 may also be suspended.

.03 The Service will monitor the timely receipt of Forms 8453–OL.

.04 The Service will monitor the quality of an On-Line Filer's transmissions throughout the filing season. The Service will also monitor the electronic portion of returns and tabulate rejections, errors, and other defects. If quality deteriorates, the On-Line Filer will receive a warning from the Service.

.05 The Service will monitor complaints about an On-Line Filer and issue a warning or suspension letter as appropriate.

.06 The Service reserves the right to suspend an On-Line Filer from participation in the Form 1040 On-Line Filing Program for violating any provision of this revenue procedure. Generally, the Service will advise a suspended On-Line Filer concerning the requirements for reacceptance into the Form 1040 On-Line Filing Program. The following reasons may lead to a warning letter and/or suspension of an On-Line Filer from the Form 1040 On-Line Filing Program (this list is not all-inclusive):

(1) the reasons listed in section 4.15 of this revenue procedure;

(2) deterioration in the format of individual transmissions;

(3) unacceptable cumulative error or rejection rate;

(4) stockpiling returns at any time while participating in the Form 1040 On-Line Filing Program;

(5) failure on the part of a Transmitter to retrieve acknowledgement files within two work days of transmission by the Service;

(6) failure on the part of a Transmitter to notify the taxpayer, as prescribed in section 5.19 of this revenue procedure, of the status of a transmitted return within two work days of receipt of the acknowledgement files from the Service;

(7) failure on the part of an On-Line Service Provider to ensure that no more than three tax returns are filed electronically by one subscriber;

(8) failure on the part of a Transmitter to ensure that it does not transmit or accept for transmission more than three electronic returns originating from one software package;

(9) significant complaints about an On-Line Filer;

(10) failure on the part of an On-Line Filer to ensure against the unauthorized use of its EFIN and/or ETIN;

(11) failure on the part of an On-Line Filer to cooperate with the Service's efforts to investigate electronic filing abuse;

(12) violation of the advertising standards described in section 11 of this revenue procedure;

(13) failure to maintain and make available records as described in section 5.20 of this revenue procedure;

(14) failure to supply a taxpayer with an accurate DCN;

(15) failure to give effective instructions to a taxpayer concerning the entry of the DCN on Form 8453–OL; or

(16) failure to timely submit a revised Form 8633 (or a letter containing the same information contained in a revised Form 8633) notifying the Service of changes described in section 4.03 or 4.04 of this revenue procedure.

.07 The Service may list in the Internal Revenue Bulletin, district office listings, district office newsletters, and on the EFS Bulletin Board the name and owner(s) of any entity suspended from the Form 1040 On-Line Filing Program and the effective date of the suspension.

.08 If a participant is suspended from participating in the Form 1040 On-Line Filing Program, the period of suspension includes the remainder of the calendar year in which the suspension occurs plus the next two calendar years. A suspended participant may submit a new application for the application period immediately preceding the end of the suspension.

SECTION 13. ADMINISTRATIVE REVIEW PROCESS FOR DENIAL OF PARTICIPATION IN THE FORM 1040 ON-LINE FILING PROGRAM

.01 An applicant that has been denied participation in the Form 1040 On-Line Filing Program has the right to an administrative review. During the administrative review process, the denial of participation remains in effect.

.02 In response to the submission of a Form 8633, the Andover Service Center will either (1) accept an applicant into the Form 1040 On-Line Filing Program, or (2) issue a proposed letter of denial that explains to the applicant why the service center proposes to reject the application to participate in the Form 1040 On-Line Filing Program.

.03 An applicant who receives a proposed letter of denial may mail or deliver, within 30 calendar days of the date of the proposed letter of denial, a written response to the Andover Service Center.

The applicant's response must address the service center's reason(s) for proposing the denial to participate.

.04 Upon receipt of an applicant's written response, the Andover Service Center will reconsider its proposed letter of denial. The service center may either (1) withdraw its proposed letter of denial and admit the applicant into the Form 1040 On-Line Filing Program, or (2) finalize the proposed denial letter.

.05 If an applicant receives a final denial letter from the Andover Service Center, the applicant is entitled to an appeal, in writing, to the Director of Practice.

.06 The appeal must be mailed or delivered to the Andover Service Center within 30 calendar days of the date of the final denial letter. An applicant's written appeal must contain a detailed explanation, with supporting documentation, of why the denial should be reversed.

.07 The Andover Service Center will, upon receipt of a written appeal to the Director of Practice, forward to the Director of Practice its file on the applicant and the material described in section 13.06 of this revenue procedure. The service center will forward these materials to the Director of Practice within 15 calendar days of receipt of the applicant's written appeal.

.08 Failure to respond within either of the 30-day periods described in sections 13.03 and 13.06 of this revenue procedure irrevocably terminates an applicant's right to an administrative review or appeal.

.09 If an application for participation in the Form 1040 On-Line Filing Program is denied, the applicant is ineligible to submit a new application for two years from the application date of the denied application.

SECTION 14. ADMINISTRATIVE REVIEW PROCESS FOR SUSPENSION FROM THE FORM 1040 ON-LINE FILING PROGRAM

.01 An On-Line Filer that has been suspended from participation in the Form 1040 On-Line Filing Program has the right to an administrative review. During the administrative review process, the suspension remains in effect.

.02 If an On-Line Filer receives a suspension letter, the On-Line Filer may mail or deliver, within 30 calendar days of the date of the suspension letter, a detailed written explanation, with supporting documentation, of why the suspension letter should be withdrawn. This written response should be sent to the district office or service center that issued the suspension letter.

.03 Upon receipt of the On-Line Filer's written response, the district office or service center will reconsider its suspension of the On-Line Filer. The district office or service center may either (1) withdraw its suspension letter, or (2) affirm the suspension.

.04 If the On-Line Filer receives a letter affirming the suspension, the On-Line Filer is entitled to an appeal, in writing, to the Director of Practice.

.05 The appeal must be mailed or delivered to the district office or service center that issued the suspension letter within 30 calendar days of the date of the letter affirming the suspension. The On-Line Filer's written appeal must contain detailed reasons, with supporting documentation, for reversal of the suspension.

.06 The district office or service center whose decision to suspend is being appealed will, upon receipt of a written appeal to the Director of Practice, forward its file on the On-Line Filer to the Director of Practice. The district office or service center will also forward to the Director of Practice the material described in section 14.05 of this revenue procedure. The district office or the service center will forward these materials within 15 calendar days of the receipt of an On-Line Filer's written request for appeal.

.07 Failure to appeal within either of the 30-day periods described in sections 14.02 and 14.05 of this revenue procedure irrevocably terminates an On-Line Filer's right to an appeal.

SECTION 15. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–62, 1996–2 C.B. 412, is superseded.

SECTION 16. EFFECTIVE DATE

This revenue procedure is effective December 29, 1997.

SECTION 17. INTERNAL REVENUE SERVICE OFFICE CONTACT

All questions regarding the electronic filing aspects of the Form 1040 On-Line Filing Program should be directed to the IRS Headquarters Electronic Filing Office. The telephone number for this purpose is (202) 283-0531 (not a toll-free number). All questions regarding the on-line aspects of this program should be directed to the IRS Headquarters Form 1040 On-Line Filing Program Analyst. The telephone number for this purpose is (202) 283-0265 (not a toll-free number). The address for the IRS Headquarters Form 1040 On-Line Filing Program Analyst is T:ETA:O:P, 5000 Ellin Road, Lanham, MD 20706.

SECTION 18. PAPERWORK ACT

The collections of information contained in this revenue procedure have 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 1545-1513.

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 collections of information in this revenue procedure are in sections 4, 5, 8, and 11 of the revenue procedure. This information is required by the IRS to implement the Form 1040 On-Line Filing Program and to enable taxpayers to file their individual income tax returns electronically through the Form 1040 On-Line Filing Program. The information will be used to ensure that taxpayers receive accurate and essential information regarding the filing of their return through the Form 1040 On-Line Filing Program and to identify the persons involved in the filing of a return through the Form 1040 On-Line Filing Program. The collections of information are required to retain the benefit of participating in the Form 1040 On-Line Filing Program. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and recordkeeping burden is 5,926 hours.

The estimated annual burden per respondent/recordkeeper varies from eight (8) minutes to 455 hours, depending on individual circumstances, with an estimated average of 423 hours (or approximately

two (2) minutes per on-line electronically filed return). The estimated number of respondents and recordkeepers is 14.

The estimated annual frequency of responses is on occasion.

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

Social Security Contribution and Benefit Base

Under authority contained in the Social Security Act ("the Act"), the Commissioner, Social Security Administration, has determined and announced (62 F.R. 58762, dated October 30, 1997) that the contribution and benefit base for remuneration paid in 1998, and self-employment income earned in taxable years beginning in 1998 is $68,400.

"Old-Law" Contribution and Benefit Base

General. The 1998 "old-law" contribution and benefit base is $50,700. This is the base that would have been effective under the Act without the enactment of the 1977 amendments. The base is computed under section 230(b) of the Act as it read prior to the 1977 amendments.

The "old-law" contribution and benefit base is used by:

(a) the Railroad Retirement program to determine certain tax liabilities and tier II benefits payable under that program to supplement the tier I payments which correspond to basic Social Security benefits,

(b) the Pension Benefit Guaranty Corporation to determine the maximum amount of pension guaranteed under the Employee Retirement Income Security Act (as stated in section 230(d) of the Social Security Act),

(c) Social Security to determine a year of coverage in computing the special minimum benefit, as described earlier, and

(d) Social Security to determine a year of coverage (acquired whenever earnings equal or exceed 25 percent of the "old-law" base for this purpose only) in computing benefits for persons who are also eligible to receive pensions based on employment not covered under section 210 of the Act.

Domestic Employee Coverage Threshold

General. Section 2 of the "Social Security Domestic Employment Reform Act of 1994" (Pub. L. 103–387) increased the threshold for coverage of a domestic employee's wages paid per employer from $50 per calendar quarter to $1,000 in calendar year 1994. The statute holds the coverage threshold at the $1,000 level for 1995 and then increases the threshold in $100 increments for years after 1995. The formula for increasing the threshold is provided in section 3121(x) of the Internal Revenue Code.

Computation. Under the formula, the domestic employee coverage threshold amount for 1998 shall be equal to the 1995 amount of $1,000 multiplied by the ratio of the national average wage index for 1996 to that for 1993. If the amount so determined is not a multiple of $100, it shall be rounded to the next lower multiple of $100.

Domestic Employee Coverage Threshold Amount. The ratio of the national average wage index for 1996, $25,913.90, compared to that for 1993, $23,132.67, is 1.1202295. Multiplying the 1995 domestic employee coverage threshold amount of $1,000 by the ratio of 1.1202295 produces the amount of $1,120.23, which must then be rounded to $1,100. Accordingly, the domestic employee coverage threshold amount is determined to be $1,100 for 1998.

Part IV. Items of General Interest

Extension of Federal Tax Deposits Due Dates for Extra Federal Holiday

Announcement 97–124

The Internal Revenue Service will extend the December 26 due date for federal tax deposits in recognition of the presidential executive order giving federal employees an extra holiday.

Normal deposit due date for payroll tax liabilities of $100,000 or more for wages paid on December 24 would be December 26. This deposit due date is extended to Monday, December 29, 1997.

The semi-weekly depositors with payroll dates Dec 20, 21, 22, 23 must deposit by Tuesday, December 30, 1997.

Foundations Status of Certain Organizations

Announcement 97–125

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:

Aden Relief Services, Alexandria, VA
African-American Family History Association, Memphis, TN
African American Men Against Narcotics, Inc., AA-MAN, Inc., Dallas, TX
Alliance for the Welfare of Animals, Springfield, MO
Allied Housing Group Ltd, St. Louis, MO
All Saints Scholarship Fund, Norfolk, VA
Almena Senior Citizens Inc., Almena, KS
Alpha Woodward Restoration Inc., Detroit, MI
Alpine Regional Education Center, Gaylord, MI
Also Morale Inc., Englewood, CO
Alternative Radio Coalition Incorporated, Charlotte, NC
Alternative Theatre Company, Phoenix, AZ
Alternative Workhaven Inc., Eudora, KS
Altrusa Foundation, Fort Worth, TX
Altrusa Teen Share Inc., Coldwater, MI
Alvarado Historical Association Inc., Alvarado, TX
Aman Community, Cleveland, OH
Amateur Hardwood Association of Red Stick, Baton Rouge, LA
Ambassadors for Christ, Nashville, NC
Amber Waves Inc., Jasper, AL
Ambulance Fund Raising Committee, Townsend, WI
Amdpa Foundation Inc., Pine Bluff, AR
Amelia Island Chorale Inc., Fernandina Beach, FL
America the Beautiful Centennial Celebration, Inc., Colorado Springs, CO
American Assistance to Eastern Europe, Inc., Satellite Beach, FL
American Association for Chronic Fatigue Syndrome, Inc., Tulsa, OK
American Bosnian Herzegovinian Association, Clinton Township, MI
American Childrens Welfare Foundation, Flora, IL
American Disabilities Association, Marshall, TX
American Foundation for Removal of Addictions, Inc., Scottsdale, AZ
American Freedom Assembly Inc., Trussville, AL
American Friends of Mesilath Yesharim, Inc., Baltimore, MD
American Friends of the William Harvey Research Institute, Inc., Philadelphia, PA
American Indian Center of Central Florida, Inc., Orlando, FL
American Mountain Guides Association, Golden, CO
American Multi-Racial Film Series, New York, NY
American Muslim Support Group Inc., Belridge, MO
American Podiatric Arthroscopic Association, Inc., Lorain, OH
American Quiz Bowl Association Inc., New Orleans, LA
American Russian Medical Exchange, Lansing, MI
American Society of Dermatology Inc., Midwest City, OK
American-Somali Council, Washington, DC
American Stories Inc., Philadelphia, PA
American Veterinary History Society, Ames, IA
American Virtuosi Foundation Inc., Birmingham, AL
American Waterfowl Association Inc., Atlanta, GA
American Way Inc., Baltimore, MD
Americans and Germans Embracin Both Nationalities in Dialogue and Association, Detroit, MI
Americans for Mentored Officer Recruitment and Education, Houston, TX
Americas Art for Life Inc., Miami, FL
Americas Favorite Pre-Teen Foundation, Inc., Lake Ariel, PA
Angleton Area Crimestoppers Inc., Angleton, TX
Animal Aid for Vermilion Area Inc., Abbeville, LA
Animal Protection League of Pulaski County, Inc., Somerset, KY
Animal Relief Fund Inc., Garland, TX
Amhe Incorporated, Chicago, IL
Amigos for Education Inc., Alice, TX
Amoco Dealers and Jobbers for Kids Corporation, White Bear Lake, MN
Anchor Ministries Inc., Conyers, GA
Andrew Jackson Institute Inc., Nashville, TN
Andrew Magee-Scott Verplank Endowment Fund, Dallas, TX
Animal Relief Fund Inc., Parker, AZ
Animal Welfare Society, Farmington, NM
Animals Pals Inc., Farmington, MI
Anioma Association of Nigeria Inc., Hyattsville, MD
Anna Jonesboro Community Pride, Inc., Anna, IL
Annual Emancipation Day Celebration, Inc., Gallipolis, OH
Annunciation Greek Orthodox Church of LR-AR Scholarship Foundation Inc., Little Rock, AR
Anoka County Tree Board Inc., Anoka, MN
Anti-Rheumatic Drug Guidelines Fund, Inc., Phoenix, AZ

Antrim-Kalkaska Literacy Council, Kewadin, MI
Apostolic Development Corporation, Detroit, MI
Applecor Foundation Inc., Chicago, IL
Aqua-Tex Swim Team Inc., Klein, TX
Aquatic Medical Research & Development, Ltd., Inc., Miami, FL
Aquia Harbor Volunteer Rescue Squad, Inc., Stafford, VA
Arab American Medical Association-Pittsburgh Chapter, Murrysville, PA
Arc Thriftown Inc., Farmington, NM
Ardbraccan Foundation Inc., Shorewood, WI
Ardis Rhinehart Kremer Home of the United Church of Christ, Conneaut, OH
Ardmore Area Rapid Responders Inc., Ardmore, AL
Area Counties Council on Alcoholism Drug Abuse, Bellville, TX
Arizona Academy of Family Physicians Foundation, Inc., Phoenix, AZ
Arizona Association of Conservation Districts, Phoenix, AZ
Campaign for Energy Efficiency in Education and Health Care, Washington, DC
Childrens Dance Co., Chattanooga, TN
Coalition for a National Memorial to Mahatma Gandhi, Potomac, MD
Committee to Restore Pop Floyd Field, Inc., Atlantic City, NJ
Cystic Fibrosis Care Group Inc., Windermere, FL
Gorgias Association Inc., Bellevue, CO
Hollister Citizens Organization, Inc., Hollister, NC
International Cultural and Friendship Association, Mililani, HI
Library Foundation of Jefferson County, Inc., Montrello, FL
Manasota Theatre Organ Society, Inc., Bradenton, FL
Mid-South Tissue Bank, Inc., Memphis, TN
Rock the Vote Education Fund, Santa Monica, CA
San Diego Flute Guild, Poway, CA
Wendy's Relief Fund, Inc., Dublin, OH
World Class School, Inc., Arlington, VA

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.

Deletions From Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 97–126

The names of organizations that no longer qualify as organizations described in section 170(c)(2) of the Internal Revenue Code of 1986 are listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that an organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170(c)(2) if the organization has not timely filed a suit for declaratory judgment under section 7428 and if the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of the activities or omissions of the organization that brought about this revocation.

If on the other hand a suit for declaratory judgment has been timely filed, contributions from individuals and organizations described in section 170(c)(2) that are otherwise allowable will continue to be deductible. Protection under section 7428(c) would begin on December 29, 1997, and would end on the date the court first determines that the organization is not described in section 170(c)(2) as more particularly set forth in section 7428(c)(1).

For individual contributors, the maximum deduction protected is $1,000, with a husband and wife treated as one contributor. This benefit is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for revocation.

Exploring Cultural and Educational Learning, Sandy, UT
Real Friends, Inc., Aurora, CO
Youth Today Leaders Tomorrow, Inc. Golden Valley, CO

Section 7428(c) Validation of Certain Contributions Made During Pendency of Declaratory Judgment Proceedings

This announcement serves notice to potential donors that the organization listed below has recently filed a timely declaratory judgment suit under section 7428 of the Code, challenging revocation of its status as an eligible donee under section 170(c)(2).

Protection under section 7428(c) of the Code begins on the date that the notice of revocation is published in the Internal Revenue Bulletin and ends on the date on which a court first determines that an organization is not described in section 170(c)(2), as more particularly set forth in section 7428(c)(1). In the case of individual contributors, the maximum amount of contributions protected during this period is limited to $1,000.00, with a husband and wife being treated as one contributor. This protection is not extended to any individual who was responsible, in whole or in part, for the acts or omissions of the organization that were the basis for the revocation. This protection also applies (but without limitation as to amount) to organizations described in section 170(c)(2) which are exempt from tax under section 501(a). If the organization ultimately prevails in its declaratory judgment suit, deductibility of contributions would be subject to the normal limitations set forth under section 170.

At Cost Services, Inc.
New York, NY

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Proc..—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral 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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[1] A cumulative finding list for previously published items mentioned 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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