Internal Revenue
bulletin

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HIGHLIGHTS OF THIS ISSUE

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

INCOME TAX

T.D. 8750, page 4.
REG–115795–97, page 33.
Temporary and proposed regulations provide guidance to a passive foreign investment company (PFIC) shareholder that makes the election under section 1295 of the Code to treat the PFIC as a qualified electing fund. A public hearing on the proposed regulations will be held on April 16, 1998.

Rev. Proc. 98–21, page 27.
Procedures concerning requests to the U.S. competent authority for assistance in resolving cases under Article XIII(8) of the U.S.—Canada Income Tax Convention are set forth.

EMPLOYEE PLANS

REG–209476–82, page 36.
Proposed regulations under section 72(p) of the Code relate to loans made from a qualified employer plan to plan participants or beneficiaries.

EXEMPT ORGANIZATIONS

Announcement 98–11, page 42.
A list is given of organizations now classified as private foundations.

EMPLOYMENT TAX

REG–209484–87; REG–209807–95, page 40.
Proposed regulations under sections 3121(v)(2) and 3306(r)(2) of the Code relate to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as "wages" for purposes of the taxes imposed by FICA and FUTA.

EXCISE TAX

T.D. 8748, page 24.
Final regulations under section 4081 of the Code relate to the application of the diesel fuel excise tax to fuel used in Alaska.

ADMINISTRATIVE

REG–100841–97, page 30.
Proposed regulations under section 6159 of the Code relate to terminations of agreements for the payment of tax liabilities in installments (installment agreements).

REG–105163–97, page 31.
Proposed regulations relate to the treatment of certain investment income under the qualifying income provisions of section 7704(d) of the Code and the application of the passive activity loss rules to publicly traded partnerships. A public hearing will be held on April 28, 1998.

Notice 98–14, page 27.
Failure to deposit federal tax; penalty abatement. An interim procedure is provided for use by taxpayers to request abatement of the failure-to-deposit penalty when the manner in which the Service applies deposits produces multiple failure-to-deposit penalties as a result of a single failure to deposit.

Announcement 98–12, page 43.
This announcement provides guidance on how to complete the worksheets for Form 8582, Passive Activity Loss Limitations, if the filer has more than one passive activity with Schedule D (Form 1040) transactions.

Announcement 98–13, page 43.
Form 3115, Application for Change in Accounting Method, and its instructions have been revised.

Announcement 98–14, page 44.
Form 5305–R, Roth Individual Retirement Trust Account; Form 5305–RA, Roth Individual Retirement Custodial Account; Form 5305–E, Education Individual Retirement Trust Account; and Form 5305–EA, Education Individual Retirement Custodial Account, are now available.

Finding Lists begin on page 48.
Announcement of Disbarments and Suspensions begins on page 45.

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 semiannual basis and are published in the first Bulletin of the succeeding semiannual period, respectively.

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

Section 1295.—Qualified Electing Fund

26 CFR 1.1295–1T: Qualified electing funds (temporary).

T.D. 8750

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 1 and 602

General Rules for Making and Maintaining Qualified Electing Fund Elections

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary regulations that provide guidance to a passive foreign investment company (PFIC) shareholder that makes the election under section 1295 (section 1295 election) to treat the PFIC as a qualified electing fund (QEF). This document also contains temporary regulations that provide guidance for shareholders that wish to make a section 1295 election that will apply on a retroactive basis (retroactive election). In addition, this document contains a temporary regulation that provides guidance under section 1291 to a PFIC shareholder that is a tax-exempt organization. Temporary regulations are needed to provide taxpayers additional time to satisfy certain requirements to make the section 1295 election. The text of these temporary regulations also serves as the text of proposed regulations REG–115795–97, page 33. In addition, this document removes § 1.1291–9(i)(1) of the final regulations, and amends § 1.1297– 3T. References to sections 1296 and 1297 in this document are references to sections 1296 and 1297 as in effect before the effective date of section 1122(a) of the Tax Relief Act of 1997.

DATES: These regulations are effective January 2, 1998.

For dates of applicability, see §§ 1.1291–1T(e)(2), 1.1293–1T(a)(2)(ii), 1.1293–1T(c)(3), 1.1295–1T(k), 1.1295–3T(h), and § 1.1297–3T(c)(3) of these regulations.

FOR FURTHER INFORMATION CONTACT: Gayle Novig, (202) 622-3840 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

These regulations are being issued without prior notice and public procedure pursuant to the Administrative Procedure Act (5 U.S.C. 553). For this reason, the collections of information contained in these regulations have been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget under control number 1545–1555. Responses to these collections of information are mandatory.

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.

For further information concerning these collections of information, and where to submit comments on the collections of information and the accuracy of the estimated burden, and suggestions for reducing this burden, please refer to the preamble to REG–115795–97.

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.

Background

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 1291, 1293, 1295, and 1297 of the Internal Revenue Code. Sections 1291, 1293, 1295, and 1297 were added by the Tax Reform Act of 1986, effective for taxable years of foreign corporations beginning after December 31, 1986. As originally enacted, the section 1295 election was an election made by the PFIC. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) amended section 1295, effective for taxable years of foreign corporations beginning after December 31, 1986, to change the section 1295 election to a shareholder-by-shareholder election. Sections 1291, 1293, and 1297 also were amended by TAMRA; sections 1293 and 1297 were further amended by the Omnibus Budget Reconciliation Act of 1993. Section 1297 also was amended by the Revenue Reconciliation Act of 1989 and the Small Business Job Protection Act of 1996. In addition, the Taxpayer Relief Act of 1997 (1997 TRA) amended section 1 to provide categories of long-term capital gain and the maximum rates of tax to which the categories are subject. In certain cases, this amendment affects the calculation of net capital gain for purposes of section 1293.

Guidance for making the election under section 1295 was first provided on March 2, 1988, in the **Federal Register** (53 F.R. 6770), with the publication of temporary regulations (T.D. 8178) relating to the section 1295 election. These temporary regulations provided guidance to PFICs making the section 1295 election and therefore became obsolete with the 1988 amendment to section 1295. The Internal Revenue Service published Notice 88–125, 1988–2 C.B. 535, to provide guidance to shareholders making the section 1295 election under section 1295, as amended. Notice 88–125 was an administrative pronouncement, as that term is used in § 1.6661–3(b)(2) of the Income Tax Regulations, and taxpayers could rely on Notice 88–125 to the same extent as a revenue ruling or a revenue procedure. Notice 88–125 stated that taxpayers could rely on the notice until regulations were published, and that those regulations would be effective for taxable years beginning after December 31, 1986.

Proposed regulations published April 1, 1992 (57 F.R. 11024), provide a general rule regarding the application of section 1291 to a PFIC shareholder that is an organization exempt from tax under chapter 1. In addition, these proposed regulations provide general rules regarding the application of section 1293 and special rules regarding the application of section 1295, including rules with respect to transfers of PFIC stock subject to a section 1295 election. Proposed regulation § 1.1295–2, published December 24, 1996 (61 F.R.

67752), permits certain shareholders to make a special section 1295 election with respect to certain preferred stock. Proposed regulation § 1.1293–2, also published December 24, 1996 (61 F.R. 67752), provides the special inclusion rules applicable to shareholders that make the special section 1295 election with respect to their preferred stock.

Temporary regulations § 1.1297–3T, published March 2, 1988 (53 F.R. 6770), provides guidance for making the deemed sale election under section 1297(b)(1) to purge the PFIC taint from stock of a foreign corporation that is treated as stock of a PFIC under section 1297(b)(1). Section 1.1291–9(i)(1) of the regulations, published December 27, 1996 (61 F.R. 68149), provides that the deemed dividend election rules of § 1.1291–9 do not apply to elections made under section 1297(b)(1). A similar rule had been provided in temporary regulations published April 1, 1992 (57 F.R. 10992). The temporary regulations, which had been effective April 1, 1992, sunset April 1, 1995.

Treasury and the Service believe that immediate guidance in the form of temporary regulations regarding the section 1295 election is necessary. First, the regulations provide significant new QEF election procedures that are beneficial to taxpayers. For example, the regulations provide procedures for both retroactive and protective elections. The benefits provided by these changes may be jeopardized, or simply unavailable (as a result of closed taxable years), if taxpayers cannot immediately rely on them. Second, although the regulations embody guidance already provided in Notice 88–125, the regulations significantly reduce the burden for making and maintaining the election and clarify, most often in favor of taxpayers, significant ambiguities left by the Notice. Treasury and the Service believe that the benefits of immediate guidance significantly outweigh any advantage obtained by issuing the regulations in proposed form only because these temporary regulations prevent prejudice to taxpayers as a consequence of a further delay in guidance and because they benefit taxpayers by providing additional time to make certain elections. Finally, the temporary regulations provide guidance concerning the manner in which section 1(h), which was added to the Code by 1997 TRA, effective for taxable years ending after May 6, 1997, applies to determine the net capital gain of the PFIC and the QEF shareholder's pro rata share of the net capital gain. Therefore, it would be impractical and contrary to public interest to issue this Treasury decision with prior notice under section 553(b) of title 5 of the United States Code.

Explanation of Provisions

A foreign corporation is a passive foreign investment company (PFIC) for a taxable year if the foreign corporation satisfies either the income or asset test of section 1296(a) for that year. A foreign corporation is a PFIC under the income test if 75 percent or more of its gross income for its taxable year is passive, or investment-type, income. Alternatively, under the asset test, a foreign corporation is a PFIC if 50 percent or more of the average fair market value of its assets during its taxable year are assets that produce or are held for the production of passive income. A shareholder of a foreign corporation that qualifies as a PFIC is subject to the interest charge regime of section 1291 with respect to certain distributions by the PFIC and certain dispositions of its stock. Generally, a shareholder may avoid the interest charge regime by making a timely election under section 1295 to treat a PFIC as a QEF, in which case the shareholder will be taxable annually under section 1293 on its pro rata shares of the ordinary earnings and net capital gain of the PFIC. Under section 1295(a), a section 1295 election will apply with respect to the PFIC if the PFIC complies with requirements prescribed by the Secretary for purposes of determining the ordinary earnings and net capital gain of the PFIC and otherwise carrying out the purposes of the PFIC provisions.

Section 1295(b)(1) provides that a shareholder may make a section 1295 election with respect to a PFIC for any taxable year of the shareholder (shareholder election year). Once made, the election will apply to that year and to all subsequent years of the shareholder unless revoked with the consent of the Secretary. Section 1295(b)(2) prescribes the time for making the election. In general, for the section 1295 election to be applicable to a taxable year, the shareholder must make the election by the due date, as extended under section 6081, for the shareholder's return for that taxable year. However, to the extent provided in regulations, a section 1295 election may be made for a taxable year after the time required if the shareholder failed to make a timely election because the shareholder reasonably believed that the foreign corporation was not a PFIC.

This document provides temporary regulations that interpret sections 1291, 1293, 1295, and 1297. In particular, the temporary regulations incorporate the rules of Notice 88–125, with certain modifications. The temporary regulations also clarify the rules of the notice and proposed regulation § 1.1295–1(b) with respect to the application of section 1295 to options, lapse of PFIC status, cessation of ownership of PFIC stock, transfer of stock subject to a section 1295 election to a pass through entity, and tax-exempt organizations. The temporary regulations also provide rules regarding invalidation, termination and revocation of a section 1295 election. In addition, the temporary regulations introduce rules for making a retroactive election. Finally, the temporary regulations provide guidance concerning the application of the deemed dividend election rules to elections under section 1297(b)(1).

1. *Rules of Notice 88–125.*

Temporary regulation § 1.1295–1T(c) through (g) adopts the rules provided in Notice 88–125, with certain modifications. These modifications reflect certain comments received with respect to the notice.

Notice 88–125 describes the requirements a shareholder must satisfy to make and maintain a section 1295 election. In particular, each year the shareholder must file Form 8621 with its income tax return and attach a PFIC Annual Information Statement (described below). In the year of election, the shareholder also must attach a Shareholder Election Statement. Notice 88–125 requires satisfaction of the election and annual reporting requirements with respect to each PFIC for which the shareholder makes the section 1295 election.

Commenters indicated that these election and annual reporting requirements

are burdensome, especially if the shareholder is making the election with respect to many foreign corporations. In response to the comments, the temporary regulations change these requirements to reduce the burden on the electing shareholder. First, the temporary regulations eliminate the need to file a Shareholder Election Statement. Second, the temporary regulations eliminate the need to file a copy of the PFIC Annual Information Statement with Form 8621 and require instead that the shareholder retain a copy of the PFIC Annual Information Statement for production upon examination by the Service. Thus, to make and maintain a section 1295 election, the shareholder need only file Form 8621 for each PFIC on an annual basis and maintain records to support the information entered on that form.

Notice 88–125 imposes certain requirements on PFICs and on intermediaries through which shareholders own PFIC stock. The notice requires a PFIC to provide its shareholders with a PFIC Annual Information Statement containing information necessary to determine each shareholder's yearly income inclusion. In the case of indirect ownership of PFIC stock, a nominee or shareholder of record that has received a PFIC Annual Information Statement may issue its own statement to the shareholder containing the relevant information in lieu of passing on the PFIC Annual Information Statement.

The temporary regulations allow PFICs and intermediaries more flexibility in fulfilling these requirements. A PFIC that owns directly or indirectly any shares of one or more PFICs may provide its shareholders with a PFIC Annual Information Statement in which it combines the required information and representations of the PFIC and any lower tier PFICs. The PFIC may use any format for a combined PFIC Annual Information Statement provided the required information and representations are clearly presented and identified with the respective corporations. Similarly, an intermediary through which a shareholder indirectly holds stock in more than one PFIC may provide the shareholder a combined statement based on multiple PFIC Annual Information Statements. Comments are requested concerning alternative reporting methods that could further reduce the burden on electing shareholders.

As provided in Notice 88–125, the PFIC Annual Information Statement must include the shareholder's pro rata shares of the ordinary earnings and net capital gain of the PFIC for the PFIC's taxable year or information that will enable the shareholder to calculate its pro rata shares. In addition, the PFIC Annual Information Statement must contain information about distributions to shareholders and a statement that the PFIC will permit the shareholder to inspect and copy its permanent books of account, records, and other documents of the PFIC necessary to determine that the ordinary earnings and net capital gain of the PFIC have been calculated according to federal income tax accounting principles. Commenters indicated that it was unclear in the notice whether a shareholder, rather than the PFIC, could calculate the requisite federal income tax information with respect to a PFIC that did not keep its books and records according to U.S. tax accounting rules. In response to the comments, the temporary regulations clarify that a shareholder may obtain the books, records and other documents of the foreign corporation necessary for the shareholder to determine the correct earnings and profits and net capital gain of the PFIC according to federal income tax principles and calculate the shareholder's pro rata shares of the PFIC's ordinary earnings and net capital gain. The temporary regulations provide that, in that case, the PFIC must include a statement in its PFIC Annual Information Statement that it has permitted the shareholder to examine the PFIC's books of account, records, and other documents necessary for the shareholder to calculate the amounts of ordinary earnings and net capital gain.

Notice 88–125 provides that a domestic partnership makes the section 1295 election rather than each individual partner that is an indirect shareholder of the PFIC by reason of the partner's interest in the partnership. The notice also provides that an S corporation makes the section 1295 election. This entity-level election in the case of domestic partnerships and S corporations reflects the view that multiple elections by the partners or S corporation shareholders would be more burdensome than the single entity-level election. The temporary regulations adopt the rules of the notice with respect to elections by domestic pass through entities, clarifying that the section 1295 election with respect to stock owned directly or indirectly by a domestic trust or estate generally is also made at the entity level. The temporary regulations also adopt the rules of the notice with respect to interests held by foreign pass through entities. Interest holders in foreign partnerships, trusts, and estates must make the section 1295 election with respect to their indirect interests in PFICs held through those entities; foreign entities may not make the section 1295 election.

Partnerships, S corporations, trusts, and estates are referred to as pass through entities in the temporary regulations. The regulations clarify that an election made by a domestic pass through entity is made in the pass through entity's capacity as a shareholder, as specially defined in temporary regulation § 1.1295–1T(j) for purposes of the section 1295 election provisions. Thus, the domestic pass through entity takes the section 1293 inclusion into account in its return for the year in which or with which the PFIC's taxable year ends, and the interest holders in the pass through entity take the section 1293 inclusion into account under the rules applicable to inclusions of income from the pass through entity. In addition, the temporary regulations clarify that if an interest holder in a domestic pass through entity transfers stock of a PFIC subject to a section 1295 election to the pass through entity, the section 1295 election continues to apply to the interest holder whether or not the pass through entity makes the section 1295 election.

Similarly, the temporary regulations clarify the effect of the termination under section 708(b) of a partnership on a section 1295 election made by the partnership. Section 1.1295–1T(b)(3)(iii) provides that, notwithstanding the termination of a section 1295 election when a partnership terminates, the partners of the former partnership that are partners of the new partnership are bound by the section 1295 election made by the former partnership whether or not the new partnership makes a section 1295 election.

Notice 88–125 does not provide any special rules concerning tax-exempt entities. As provided in proposed regulations under section 1291 (see Regulation Project INTL–656–87, published at 1992–1

C.B. 1124), section 1291 and the regulations under section 1291 apply to a tax-exempt organization that is a shareholder of a PFIC that is not a pedigreed QEF, within the meaning of §1.1291–9(j)(2)(ii), only if a dividend from the PFIC would be taxable to the organization under subchapter F. Section 1.1291–1T(e) of these temporary regulations provides the same rule. To prevent such a tax-exempt organization from being subject to an unnecessary section 1295 election that may have adverse consequences to the tax-exempt entity (*e.g.*, an excise tax on gross investment income of a private foundation that arises as a consequence of a section 1295 election), the temporary regulations provide a rule that precludes a tax-exempt entity that is not taxable with respect to dividends from a PFIC from making a section 1295 election with respect to that PFIC or from being subject to a pass through entity level election.

Commenters indicated that Notice 88–125 is unclear about which taxable year of the PFIC is the first taxable year to which the section 1295 election applies. Temporary regulation § 1.1295–1T(c)(2) clarifies that the section 1295 election is effective with respect to the taxable year of the foreign corporation that ends during the shareholder's election year. Because certain shareholders may have misinterpreted Notice 88–125, the Commissioner will respect a section 1295 election made prior to February 1, 1998, that was intended to be effective for the taxable year of the PFIC that began during the shareholder's election year provided that it is clear from all the facts and circumstances that the shareholder intended the election to be effective for that taxable year of the foreign corporation. For example, a calendar year shareholder that made the section 1295 election in its 1995 return with respect to a foreign corporation whose taxable year began in 1995 and ended in 1996, with the intention that the election first apply to the foreign corporation's taxable year ended in 1996, will be treated as having made a valid section 1295 election with respect to that year.

2. *Additional Clarifications.*

A. *Options.*

Options with respect to PFIC stock present unique problems under section 1295. Section 1297(a)(4) provides that, under regulations, an option to acquire stock may be treated as ownership of stock.

Proposed regulations under section 1291 (see Regulation Project INTL–656–87, published in 1992–1 C.B. 1124) provide that options are treated like stock for purposes of section 1291. Under proposed regulation § 1.1291–1(d), an option is considered to be stock of a PFIC that is not a pedigreed QEF for purposes of applying section 1291 to a disposition of the option, unless the holder of the actual stock which is subject to the option is currently including income from the stock under section 1293. Under proposed regulation § 1.1291–1(h)(3), the holding period of stock acquired upon exercise of an option treated as stock under § 1.1291–1(d) includes the period the option was held. These rules recognize that the value of an option is linked to the value of the underlying stock and therefore such an option should be subject to the PFIC rules.

Because of the potential for application of section 1291 to options or stock acquired upon exercise of options, some option holders have requested that regulations provide rules for making a section 1295 election with respect to an option. Application of a section 1295 election and the section 1293 current inclusion regime to options would present serious computational issues and would be administratively burdensome. Therefore, the temporary regulations continue the rule that any shareholder's section 1295 election with respect to stock of a PFIC does not apply to options to acquire stock of the PFIC and that an option holder may not make a section 1295 election with respect to the optioned stock. Accordingly, if a shareholder of stock subject to a section 1295 election exercises an option to purchase additional shares of stock of that PFIC, the stock received will be subject to the section 1295 election made by the shareholder, but, because of the rules of proposed regulation § 1.1291–1(h)(3), the stock may be treated as stock of an unpedigreed QEF.

Comments are requested concerning the option rule. In particular, comments are requested that identify any administratively feasible mechanisms that would permit a shareholder to make a section 1295 election that will apply to options.

B. *Section 1295 Election Made in a Joint Return.*

Section 1.1295–1T(b)(4) of the temporary regulations clarifies the application of a section 1295 election made in a joint return within the meaning of section 6013. The temporary regulations provide that a section 1295 election made in a joint return will be treated as having been made by both spouses that join in the filing of that return.

C. *Lapse in PFIC Status or in Ownership.*

Section 1.1295–1T(c)(2) of the temporary regulations clarifies the status of a shareholder's section 1295 election with respect to a foreign corporation after the foreign corporation ceases to be a PFIC and a QEF, or after the shareholder ceases to be a shareholder of the PFIC. In general, once a section 1295 election is made with respect to a corporation, it remains in effect, although not applicable, during those years that the foreign corporation is not a PFIC. Therefore, if the corporation requalifies as a PFIC, the section 1295 election previously made is still valid, and the shareholder is required to satisfy the requirements of that election. Furthermore, as indicated in H.R. No. 795, 100th Cong., 2d Sess., at 567 (1988), an election remains in effect with respect to a shareholder, although dormant, after a shareholder disposes of its entire interest in the PFIC. Upon the shareholder's reacquisition of an interest in the PFIC, the section 1295 election will apply to the newly acquired stock.

D. *Invalidation, Termination, and Revocation of Section 1295 Elections.*

As provided in temporary regulation § 1.1295–1T(i)(1), the Commissioner has discretion to invalidate or terminate a section 1295 election if the shareholder or the QEF fails to satisfy the section 1295 election requirements. However, intentional failure to satisfy the section 1295 election requirements will not automatically result in invalidation or termination. If the Commissioner invalidates a section 1295 election, the shareholder will be treated as if it never made a section 1295 election with respect to the PFIC. If the Commissioner terminates a section 1295 election for a taxable year, the section

1295 election will be valid for all taxable years before that year, but inapplicable to that year and all subsequent taxable years.

Once a shareholder makes a section 1295 election, the shareholder may revoke its section 1295 election only with the consent of the Commissioner. Temporary regulation § 1.1295–1T(i)(2) provides the rules for requesting consent to revoke an election.

The effects of an invalidation, termination, or revocation of a section 1295 election are provided in § 1.1295–1T(i)(3) of the temporary regulations. In the Commissioner's discretion, stock of a foreign corporation, with respect to which the section 1295 election is invalidated, terminated, or revoked will be treated as sold as of the last day of the PFIC's last taxable year as a QEF. The Commissioner also has the discretion to impose any other terms and conditions that the Commissioner deems necessary to ensure a shareholder's compliance with sections 1291 through 1297. In addition, revocation will terminate all section 1294 elections.

Section 1.1295–1T(i)(4) of the temporary regulations permits a shareholder to make another section 1295 election with respect to the PFIC after the fifth taxable year following the invalidation, termination, or revocation. However, the shareholder may request consent to make the section 1295 election for an earlier taxable year.

3. *Section 1293.*

The temporary regulations provide guidance to PFICs concerning the application of section 1(h) to section 1293 and the calculation of net capital gain. Section 1.1293–1T(a)(2) of the temporary regulations provides three alternatives for a QEF to calculate and report net capital gain. First, the PFIC may calculate and report to its shareholders the amount of each category of long-term capital gain provided in section 1(h). Alternatively, the PFIC may determine and report a single amount of net capital gain, stating that that amount of long-term capital gain is subject to the highest capital gain rate of tax applicable to the shareholder. Under the third option, the PFIC may treat the total of its earnings and profits for the taxable year as ordinary earnings. The provision of these options is intended to simplify compliance with the requirements of sections 1293 and 1295. It is anticipated that, without providing these options, some PFICs would not be willing or able to calculate the categories of net capital gain required by section 1(h) and therefore would not provide the information necessary for a QEF shareholder to maintain a valid section 1295 election. A shareholder that has access to information necessary to calculate its pro rata share of the PFIC's ordinary earnings and net capital gain may also use any of these options. The Service requests comments about how net capital gain should be calculated, especially in light of the 1997 Act changes to section 1.

The temporary regulations under section 1293 also clarify the application of the current inclusion rules of section 1293 to interests in a QEF held through a domestic pass through entity. The temporary regulations provide generally that a U.S. person that is a shareholder of the QEF by reason of an interest in a domestic pass through entity takes into account its pro rata shares of the ordinary earnings and net capital gain of the QEF attributable to the QEF shares held by the pass through entity according to the general rules applicable to inclusions of income from the pass through entity.

4. *Exempt organizations subject to section 1291.*

As stated above, the temporary regulations include the rule of proposed regulation § 1.1291–1(e). Under temporary regulation § 1.1291–1T(e), if the shareholder of a PFIC is an organization exempt from tax under this chapter (including an Individual Retirement Account (IRA)), section 1291 and these regulations apply to such shareholder only if a dividend from the PFIC would be taxable to the organization under subchapter F.

5. *Effective Dates of Temporary Regulations §§ 1.1291–1T(e), 1.1293–1T(a)(2), 1.1293–1T(c) and 1.1295–1T.*

As stated above, Notice 88–125 provides that the notice's rules will be provided in regulations applicable to taxable years beginning after 1986. However, because the temporary regulations do not adopt the rules of Notice 88–125 in their entirety, the temporary regulations will not be retroactively applied. Therefore, § 1.1295–1T(c) through (j) will apply to taxable years of shareholders beginning after December 31, 1997. As provided in § 1.1295–1T(h), the Internal Revenue Service will honor taxpayer reliance on Notice 88–125 for taxable years beginning after December 31, 1986, and before January 1, 1998. Thus, if a person made a valid section 1295 election under the rules of Notice 88–125 for taxable years beginning before January 1, 1998, and, for those taxable years, complied with the rules of the notice relating to maintaining that election, the election remains in effect for taxable years beginning after December 31, 1997. However, elections made under Notice 88–125, as well as elections made under these temporary regulations, must be maintained as provided in the temporary regulations.

Temporary regulation § 1.1291–1T(e) will apply on and after April 1, 1992. Section 1.1293–1T(a)(2) of the temporary regulations will apply to sales by QEFs during their taxable years ending on or after May 7, 1997. Temporary regulation §§ 1.1293–1T(c) and 1.1295–1T(b)(2)-(iii), (b)(3), and (b)(4) will apply to taxable years of shareholders beginning after December 31, 1997.

6. *Retroactive Section 1295 Elections.*

a. *In General.*

Section 1295(b)(2) provides that, to the extent provided in regulations, a shareholder may make a section 1295 election with respect to a foreign corporation later than the election due date if the shareholder failed to make a timely section 1295 election because the shareholder reasonably believed that the foreign corporation was not a PFIC. In temporary regulation § 1.1295–3T, Treasury and the Service interpret section 1295(b)(2) to permit a shareholder of a PFIC to make a retroactive election in certain limited circumstances where the shareholder possessed reasonable belief that the corporation was not a PFIC or the shareholder demonstrates that it reasonably relied on the advice of a qualified tax professional.

As described below, the temporary regulations set forth two distinct sets of rules for making a retroactive election. Under the first set of rules, a shareholder of a PFIC that meets certain conditions may make a retroactive election without obtaining the consent of the Commissioner

(protective regime). A shareholder may make a retroactive election under the protective regime only if the shareholder possessed reasonable belief as of the election due date that the foreign corporation was not a PFIC. A shareholder of a PFIC may make a retroactive election under the protective regime even after the issue of PFIC status has been raised in an audit by the Service.

Under the second set of rules, a shareholder may make a retroactive election only after obtaining the Commissioner's consent (consent regime). To make a retroactive election under the consent regime, the shareholder must demonstrate, to the satisfaction of the Commissioner, that the shareholder's failure to make a timely section 1295 election resulted from the shareholder's reasonable reliance on the advice of a qualified tax professional. A shareholder of a PFIC may not make a retroactive election under the consent regime unless the shareholder files a request for consent before the issue of PFIC status is raised on audit.

The temporary regulations provide the exclusive rules for making a retroactive election. Thus, a shareholder that does not satisfy the requirements of the temporary regulations may not seek relief under any other provision of the law, including § 301.9100 regulations. Although such a shareholder may not make a retroactive election, the shareholder may be able to attain certain benefits associated with a retroactive election by making a section 1295 election for the current year together with a purging election under section 1291(d)(2).

b. *Protective Regime.*

A shareholder that satisfies the requirements of the protective regime may make a retroactive election under the rules of temporary regulation § 1.1295–3T(c) through (e) without obtaining the Commissioner's consent. This regime requires that the shareholder possess reasonable belief, contemporaneous with the election due date, that the foreign corporation was not a PFIC.

The legislative history of section 1295 suggests that in certain circumstances a shareholder that reasonably believed that a foreign corporation was not a PFIC for a taxable year (*e.g.*, based on a reasonable valuation of the corporation's assets) may make a retroactive election if the Service determines, upon examination, that the corporation was in fact a PFIC for such taxable year *(e.g.*, based on the Service's valuation of the corporation's assets for the taxable year). Consistent with the legislative history, temporary regulation § 1.1295–3T(c) through (e) permits a shareholder to make a retroactive election for a taxable year of the shareholder (retroactive election year), even if the Service raises the PFIC status of the corporation upon audit. Although the shareholder need not request the Service's consent to make a retroactive election under this regime, the shareholder must satisfy certain conditions to make a retroactive election.

First, except for certain small shareholders, the shareholder must be able to establish that the shareholder reasonably believed, within the meaning of temporary regulation § 1.1295–3T(d), as of the election due date, that the foreign corporation was not a PFIC. Temporary regulation § 1.1295–3T(d) interprets the reasonable belief standard to require an actual determination by the shareholder, based on a good faith application of the law, that a foreign corporation was not a PFIC. Therefore, to satisfy the reasonable belief requirement, the shareholder must know and understand the PFIC provisions, and must make a good faith effort to apply the income and asset tests of section 1296 to determine whether the foreign corporation is a PFIC.

Except for certain small shareholders, a shareholder must file a single Protective Statement pursuant to temporary regulation § 1.1295–3T(c) that applies to a taxable year to preserve the shareholder's ability to make a retroactive election with respect to such taxable year of the shareholder and subsequent taxable years. The Protective Statement must contain information describing the basis for the shareholder's conclusion as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended in the first taxable year of the shareholder for which the Protective Statement applies. As part of the Protective Statement, the shareholder must extend the periods of limitations for the assessment of taxes determined under sections 1291 through 1297 (PFIC related taxes) for all taxable years to which the Protective Statement will apply, as provided in § 1.1295–3T(c)(4) of the temporary regulations. The shareholder also must include certain additional information in the Protective Statement. A special transition rule permits shareholders to use the protective regime for taxable years ending prior to January 2, 1998, provided the periods of limitations on the assessment of taxes for such years have not expired.

Temporary regulation § 1.1295–3T(e) provides special rules for certain small shareholders. A shareholder that qualifies under § 1.1295–3T(e) for a taxable year will not be required to satisfy the reasonable belief requirement or file a Protective Statement to preserve the shareholder's ability to make a retroactive election with respect to such year (a qualified shareholder).

Except as provided below, a shareholder is a qualified shareholder only if the shareholder owns, directly, indirectly or constructively, less than two percent of the vote and value of each class of stock of the foreign corporation during such year, and has not filed a Protective Statement that applies to an earlier year included in the shareholder's holding period of stock of the foreign corporation. In addition, for the special rule to apply to a taxable year of the shareholder, the foreign corporation or its U.S. counsel must have indicated in a corporate filing, shareholder mailing or similar document that the foreign corporation reasonably believed that it was not a PFIC for the taxable year of the foreign corporation that ended with or within such taxable year of the shareholder. However, no shareholder will be a qualified shareholder if the shareholder knew that the corporation was in fact a PFIC or knew or had reason to know that a corporate filing relating to the corporation's PFIC status was inaccurate. For this purpose, a shareholder will be treated as knowing that the corporation was in fact a PFIC if the principal activity of the foreign corporation is owning or trading a diversified portfolio of stock, securities, or other financial contracts. A qualified shareholder that makes a valid retroactive election in its earliest open taxable year in which the foreign corporation is a PFIC may, subject to certain conditions, be treated as a shareholder of a pedigreed QEF even if the period of limitations for the assessment of taxes for an

earlier taxable year in which the corporation qualified as a PFIC has expired.

c. *Consent Regime.*

Certain taxpayers have urged the Service to interpret the reasonable belief requirement of section 1295(b)(2) to allow a shareholder to make a retroactive election if the shareholder or its tax adviser did not know or properly apply the PFIC rules. In particular, certain taxpayers have recommended adoption of the reasonable action and good faith standard of § 301.9100 regulations for demonstrating reasonable belief.

Treasury and the Service recognize that the PFIC rules are complex and, in some cases, difficult for shareholders to apply. Accordingly, the temporary regulations provide that, in certain limited circumstances, a shareholder may obtain the Commissioner's consent to make a retroactive election, even if the shareholder failed to know or properly apply the PFIC rules in the earlier year. Under temporary regulation § 1.1295–3T(f), a shareholder that reasonably relied on the advice of a qualified tax professional may request consent to make a retroactive election.

In response to taxpayer comments, Treasury and the Service have incorporated into the consent regime certain rules set forth in § 301.9100 regulations. As described below, temporary regulation § 1.1295–3T(f)(1) and (4), respectively, require the shareholder to have reasonably relied on a qualified tax professional and to document such reliance. The Service will not grant consent under this regime if doing so would prejudice the interests of the government by placing the shareholder in a position more favorable than if the shareholder had made the section 1295 election on a timely basis. The temporary regulations provide that in certain cases the interests of the government may be preserved by a closing agreement between the Service and the shareholder requiring the shareholder to make a payment to the government that compensates the government for amounts that would have been due in respect of closed years affected by the retroactive election.

Under temporary regulation § 1.1295–3T(f)(2), the Service will treat a shareholder as having reasonably relied on a qualified tax professional (including an employee of the shareholder), within the meaning of the § 301.9100 regulations, if the qualified tax professional failed to identify the corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, a section 1295 election. Therefore, if a qualified tax professional, due to ignorance of the law or negligence, failed to identify the corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, the section 1295 election, the Commissioner may consent to a retroactive election. However, in no event will the Commissioner consent to a retroactive election if, prior to the application for such consent, the Service has raised the PFIC status of the foreign corporation in an audit of the retroactive election year or any subsequent year. Furthermore, a shareholder may not disregard knowledge that the corporation was a PFIC or advice or knowledge relating to the tax consequences of owning stock of a PFIC and then request relief under this regime.

d. *Who Makes a Retroactive Election and Who Satisfies the Requirements of the Protective or Consent Regime.*

Temporary regulation § 1.1295–3T adopts the rules of temporary regulation § 1.1295–1T(d), relating to who may make a section 1295 election, for purposes of determining the appropriate person to satisfy the requirements of the protective or consent regime and to make a retroactive election. Consistent with these rules, temporary regulation § 1.1295–3T(c)(3) provides that the person that executes and files the Protective Statement under the protective regime is the person that makes the section 1295 election, as provided in § 1.1295–1T(d). Temporary regulation § 1.1295–3T(f)(4)(vi) sets forth a similar rule for requests for consent under the consent regime. In addition, temporary regulation § 1.1295–3T(g)(3) provides for an entity-level retroactive election in the case of domestic partnerships, S corporations, domestic nongrantor trusts, and domestic estates that own stock of a PFIC, and a partner or beneficiary-level retroactive election in the case of foreign partnerships, foreign trusts, domestic grantor trusts, and foreign estates that own stock of a PFIC.

The Service welcomes comments concerning the benefits of requiring certain entities, rather than their interest holders, to satisfy the requirements under the protective and consent regimes. In particular, comments are requested concerning whether requiring S corporations, domestic nongrantor trusts, and domestic estates to satisfy the requirements of the protective regime at the entity-level is inappropriate.

e. *Making a Retroactive Election.*

A shareholder that has satisfied the requirements of the protective regime or has obtained the consent of the Commissioner under the consent regime must comply with the rules in temporary regulation § 1.1295–3T(g) for making a retroactive election. In general, the shareholder must file an amended return for the retroactive election year in which the shareholder complies with the requirements for making a section 1295 election, report its pro rata shares of the ordinary earnings and net capital gain of the foreign corporation for that year (section 1293 inclusion), if any, and pay any taxes resulting from the redetermination of its income and any applicable section 6621 interest. The shareholder also must file amended returns for the taxable years that follow the retroactive election year in which the foreign corporation is a PFIC and a QEF to report the section 1293 inclusion for each of these years, and pay the resulting tax and section 6621 interest. If the shareholder's taxable year in which the corporation first qualified as a PFIC, or the retroactive election year or any subsequent taxable years, are closed for the assessment of PFIC related taxes (*i.e.*, in certain cases where the shareholder is a qualified shareholder or the shareholder has obtained the consent of the Commissioner to file a retroactive election), the shareholder must file amended returns to report section 1293 inclusions in all open affected years beginning with the first taxable year open for the assessment of tax on such amounts.

7. *Removal of § 1.1291–9(i)(1).*

Section 1121 of the 1997 TRA amends section 1296, adding section 1296(e). Section 1296(e) provides that after December 31, 1997, a controlled foreign corporation (as defined in section 957(a))

(CFC) will not be treated as a PFIC with respect to a U.S. shareholder (as defined in section 951(b)) of the CFC. After a shareholder ceases to qualify for this exception, because the shareholder ceases to be subject to subpart F, generally the shareholder will have a new holding period for purposes of the PFIC provisions pursuant to section 1296(e)(3)(A). However, pursuant to section 1296(e)(3)(B), if the foreign corporation was a nonqualified fund before the shareholder qualified for this exception, and the shareholder did not make the section 1297(b)(1) election to purge the stock of its PFIC taint, the shareholder will not get a new holding period when it ceases to qualify for the exception for U.S. shareholders of CFCs. Congress, in the Conference Report to the 1997 TRA, H.R. Rept. 105–220, 105th Congress, 1st session, at 625, stated that "the stock held by such shareholder continues to be treated as PFIC stock unless the shareholder makes an election to pay tax and an interest charge with respect to the unrealized appreciation in the stock or the accumulated earnings of the corporation." Congress thus indicated its intent that a shareholder may apply the rules of either section 1291(d)(2)(A), the deemed sale election, or section 1291(d)(2)(B), the deemed dividend election, when making the section 1297(b)(1) election to purge a former PFIC of its PFIC taint. In order to give effect to that intent, Treasury and the IRS have decided to remove § 1.1291–9(i)(1), which provides that the rules of § 1.1291–9, the deemed dividend election, do not apply to an election under section 1297(b)(1). The removal of § 1.1291–9(i)(1) is effective as of January 2, 1998. Section 1.1291–9(i)(2) is not affected by the removal of § 1.1291–9(i)(1).

8. *Section 1297.*

The temporary regulations amend § 1.1297–3T to provide that a shareholder of a former PFIC, within the meaning of § 1.1291–9(j)(2)(iv), that was a CFC during its last taxable year as a PFIC under section 1296(a), may apply the rules of the deemed dividend election under section 1291(d)(2)(B) and § 1.1291–9 to its section 1297(b)(1) election made by the time and in the manner provided in § 1.1297–3T(b). If the time for making a section 1297(b)(1) election, provided in § 1.1297–3T(b), expired before January 2, 1998, a shareholder that applied the rules of section 1291(d)(2)(A) and § 1.1291–10 to a section 1297(b)(1) election, made with respect to a former PFIC that was a CFC in its last taxable year as a PFIC under section 1296(a), may file an amended return for its taxable year that includes the termination date, as defined in § 1.1297–3T(a), and apply the rules of the deemed dividend election to its section 1297(b)(1) election at any time before the expiration of the period of limitations for the assessment of taxes for that taxable year. Section 1.1297–3T(c) is effective as of January 2, 1998.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business. An initial regulatory flexibility analysis has been prepared for the proposed regulations for which these temporary regulations serve as a text and which is set forth in REG–115795–97.

Drafting Information

The principal authors of these regulations are Gayle Novig and Judith Cavell Cohen, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 1 and 602 are amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.1291–1T also issued under 26 U.S.C. 1291.* * *

Section 1.1293–1T also issued under 26 U.S.C. 1293.* * *

Section 1.1295–1T also issued under 26 U.S.C. 1295(b).

Section 1.1295–3T also issued under 26 U.S.C. 1295(b).* * *

§ 1.1291–0 [Amended]

Par. 2. Section 1.1291–0 is amended by removing and reserving the entry for § 1.1291–9(i)(1).

Par. 3. The section heading and introductory text for § 1.1294–0 are added to read as follows:

§ 1.1294–0 Table of contents.

This section contains a listing of the headings for § 1.1294–1T.

Par. 4. The section heading and introductory text for § 1.1297–0 are added to read as follows:

§ 1.1297–0 Table of contents.

This section contains a listing of the headings for § 1.1297–3T.

§ 1.1291–0T [Amended]

Par. 5. Section 1.1291–0T is amended by:

1. Transferring the listing of the section heading and entries for § 1.1294–1T to new § 1.1294–0.

2. Transferring the listing of the section heading and entries for § 1.1297–3T to new § 1.1297–0.

3. Removing the section heading and introductory text.

Par. 6. Section 1.1291–1T is added to read as follows.

§ 1.1291–1T Taxation of U.S. persons that are shareholders of PFICs that re not pedigreed QEFs (temporary).

(a) through (d) [Reserved].

(e) *Exempt organization as shareholder*—(1) *In general.* If the shareholder of a PFIC is an organization exempt from tax under this chapter, section 1291 and these regulations apply to such shareholder only if a dividend from the PFIC would be taxable to the organization under subchapter F.

(2) *Effective date.* Paragraph (e)(1) of this section is applicable on and after April 1, 1992.

§ 1.1291–9 [Amended]

Par. 7. Section 1.1291–9 is amended by removing and reserving paragraph (i)(1).

Par. 8. Section 1.1293–0 is added to read as follows.

§ 1.1293–0 Table of contents.

This section contains a listing of the headings for § 1.1293–1T.

§ 1.1293–1T Current inclusion of income of qualified electing funds (temporary).

(a) In general. [Reserved].
(1) Other rules. [Reserved].
(2) Net capital gain defined.
(i) In general.
(ii) Effective date.
(b) Other rules. [Reserved].
(c) Application of rules of inclusion with respect to stock held by a pass through entity.
(1) In general.
(2) QEF stock transferred to a pass through entity.
(i) Pass through entity makes a section 1295 election.
(ii) Pass through entity does not make a section 1295 election.
(3) Effective date.

Par. 9. Section 1.1293–1T is added to read as follows:

§ 1.1293–1T Current taxation of income from qualified electing funds (temporary).

(a) *In general.* [Reserved].

(1) *Other rules.* [Reserved].

(2) *Net capital gain defined*—(i) *In general.* This paragraph (a)(2) defines the term net capital gain for purposes of sections 1293 and 1295 and the regulations under those sections. The QEF, as defined in § 1.1291–9(j)(2)(i), in determining its net capital gain for a taxable year, may either—

(A) Calculate and report the amount of each category of long-term capital gain provided in section 1(h) that was recognized by the PFIC in the taxable year;

(B) Calculate and report the amount of net capital gain recognized by the PFIC in the taxable year, stating that that amount is subject to the highest capital gain rate of tax applicable to the shareholder; or

(C) Calculate its earnings and profits for the taxable year and report the entire amount as ordinary earnings.

(ii) *Effective date.* Paragraph (a)(2)(i) of this section is applicable to sales by QEFs during their taxable years ending on or after May 7, 1997.

(b) *Other rules.* [Reserved].

(c) *Application of rules of inclusion with respect to stock held by a pass through entity*—(1) *In general.* A domestic pass through entity takes into account its pro rata shares of the ordinary earnings and net capital gain attributable to the QEF shares held by the pass through entity. A U.S. person that indirectly owns QEF shares through the domestic pass through entity accounts for its pro rata shares of ordinary earnings and net capital gain attributable to the QEF shares according to the general rules applicable to inclusions of income from the domestic pass through entity. For the definition of pass through entity, see § 1.1295–1T(j).

(2) *QEF stock transferred to a pass through entity*—(i) *Pass through entity makes a section 1295 election.* If a shareholder transfers stock subject to a section 1295 election to a domestic pass through entity of which it is an interest holder and the pass through entity makes a section 1295 election with respect to that stock, as provided in § 1.1295–1T(d)(2), the shareholder takes into account its pro rata shares of the ordinary earnings and net capital gain attributable to the QEF shares under the rules applicable to inclusions of income from the pass through entity.

(ii) *Pass through entity does not make a section 1295 election.* If the pass through entity does not make a section 1295 election with respect to the PFIC, the shares of which were transferred to the pass through entity subject to the 1295 election of the shareholder, the shareholder continues to be subject, in its capacity as an indirect shareholder, to the income inclusion rules of section 1293 and reporting rules required of shareholders of QEFs. Proper adjustments to reflect an inclusion in income under section 1293 by the indirect shareholder must be made, under the principles of § 1.1291–9(f), to the basis of the indirect shareholder's interest in the pass through entity.

(3) *Effective date.* Paragraph (c) of this section is applicable to taxable years of shareholders beginning after December 31, 1997.

Par. 10. Section 1.1295–0 is added to read as follows:

§ 1.1295–0 Table of contents.

This section contains a listing of the headings for §§ 1.1295–1T and 1.1295–3T.

§ 1.1295–1T Qualified electing funds (temporary).

(a) In general. [Reserved].
(b) Application of section 1295 election. [Reserved].
(1) Election personal to shareholder. [Reserved].
(2) Election applicable to specific corporation only.
(i) In general. [Reserved].
(ii) Stock of QEF received in a nonrecognition transfer. [Reserved].
(iii) Exception for options.
(3) Application of general rules to stock held by a pass through entity.
(i) Stock subject to a section 1295 election transferred to a pass through entity.
(ii) Limitation on application of pass through entity's section 1295 election.
(iii) Effect of partnership termination on section 1295 election.
(iv) Characterization of stock held through a pass through entity.
(4) Application of general rules to a taxpayer filing a joint return under section 6013.
(c) Effect of section 1295 election.
(1) In general.
(2) Years to which section 1295 election applies.
(i) In general.
(ii) Effect of PFIC status on election.
(iii) Effect on election of complete termination of a shareholder's interest in the PFIC.
(iv) Effect on section 1295 election of transfer of stock to a domestic pass through entity.
(v) Examples.
(d) Who may make a section 1295 election.
(1) General rule.
(2) Application of general rule to pass through entities.
(i) Partnerships.
(A) Domestic partnership.
(B) Foreign partnership.
(ii) S corporation.
(iii) Trust or estate.

(A) Domestic trust or estate.
(*1*) Nongrantor trust or estate.
(*2*) Grantor trust.
(B) Foreign trust or estate.
(*1*) Nongrantor trust or estate.
(*2*) Grantor trust.
(iv) Indirect ownership of the pass through entity or the PFIC.
(3) Member of consolidated return group as shareholder.
(4) Option holder.
(5) Exempt organization.
(e) Time for making a section 1295 election.
(f) Manner of making a section 1295 election and the annual election requirements of the shareholder.
(1) Manner of making the election.
(2) Annual election requirements.
(i) In general.
(ii) Retention of documents.
(g) Annual election requirements of the PFIC or intermediary.
(1) PFIC Annual Information Statement.
(2) Alternative documentation.
(3) Annual Intermediary Statement.
(4) Combined statements.
(i) PFIC Annual Information Statement.
(ii) Annual Intermediary Statement.
(h) Transition rules.
(i) Invalidation, termination or revocation of section 1295 election.
(1) Invalidation or termination of election at the discretion of the Commissioner.
(i) In general.
(ii) Deferral of section 1293 inclusion.
(iii) When effective.
(2) Shareholder revocation.
(i) In general.
(ii) Time for and manner of requesting consent to revoke.
(A) Time.
(B) Manner of making request.
(iii) When effective.
(3) Effect of invalidation, termination, or revocation.
(4) Election after invalidation, termination, or revocation.
(j) Definitions.
(k) Effective date.

§ 1.1295–3T Retroactive elections (temporary).

(a) In general.
(b) General rule.
(c) Protective Statement.
(1) In general.
(2) Reasonable belief statement.
(3) Who executes and files the Protective Statement.
(4) Waiver of the periods of limitations.
(i) Time for and manner of extending periods of limitations.
(A) In general.
(B) Application of general rule to domestic partnerships.
(*1*) In general.
(*2*) Special rules.
(*i*) Addition of partner to non-TEFRA partnership.
(*ii*) Change in status from non-TEFRA partnership to TEFRA partnership.
(C) Application of general rule to domestic nongrantor trusts and domestic estates.
(D) Application of general rule to S corporations.
(E) Effect on waiver of complete termination of a pass through entity or pass through entity's business.
(F) Application of general rule to foreign partnerships, foreign trusts, domestic or foreign grantor trusts, and foreign estates.
(ii) Terms of waiver.
(A) Scope of waiver.
(B) Period of waiver.
(5) Time for and manner of filing a Protective Statement.
(i) In general.
(ii) Special rule for taxable years ended before January 2, 1998.
(6) Applicability of the Protective Statement.
(i) In general.
(ii) Invalidity of the Protective Statement.
(7) Retention of Protective Statement and information demonstrating reasonable belief.
(d) Reasonable belief.
(1) In general.
(2) Knowledge of law required.
(e) Special rules for qualified shareholders.
(1) In general.
(2) Qualified shareholder.
(3) Exceptions.
(f) Special consent.
(1) In general.
(2) Reasonable reliance on a qualified tax professional.
(i) In general.
(ii) Shareholder deemed to have not reasonably relied on a qualified tax professional.
(3) Prejudice to the interests of the United States government.
(i) General rule.
(ii) Elimination of prejudice to the interests of the United States government.
(4) Procedural requirements.
(i) Filing instructions.
(ii) Affidavit from shareholder.
(iii) Affidavits from other persons.
(iv) Other information.
(v) Notification of Internal Revenue Service.
(vi) Who requests special consent under this paragraph (f) and who enters into a closing agreement.
(g) Time for and manner of making a retroactive election.
(1) Time for making a retroactive election.
(i) In general.
(ii) Transition rule.
(iii) Ownership not required at time retroactive election is made.
(2) Manner of making a retroactive election.
(3) Who makes the retroactive election.
(4) Other elections.
(i) Section 1291(d)(2) election.
(ii) Section 1294 election.
(h) Effective date.

Par. 11. Section 1.1295–1T is added to read as follows:

§ 1.1295–1T Qualified electing funds (temporary).

(a) *In general.* [Reserved].

(b) *Application of section 1295 election.* [Reserved].

(1) *Election personal to shareholder.* [Reserved].

(2) *Election applicable to specific corporation only—*

(i) *In general.* [Reserved].

(ii) *Stock of QEF received in a nonrecognition transfer.* [Reserved].

(iii) *Exception for options.* A shareholder's section 1295 election does not apply to any option to buy stock of the PFIC.

(3) *Application of general rules to stock held by a pass through entity*—(i)

Stock subject to a section 1295 election transferred to a pass through entity. A shareholder's section 1295 election will not apply to a domestic pass through entity to which the shareholder transfers stock subject to a section 1295 election, or to any other U.S. person that is an interest holder or beneficiary of the domestic pass through entity. However, as provided in paragraph (c)(2)(iv) of this section (relating to a transfer to a domestic pass through entity of stock subject to a section 1295 election), a shareholder that transfers stock subject to a section 1295 election to a pass through entity will continue to be subject to the section 1295 election with respect to the stock indirectly owned through the pass through entity and any other stock of that PFIC owned by the shareholder.

(ii) *Limitation on application of pass through entity's section 1295 election.* Except as provided in paragraph (c)(2)(iv) of this section, a section 1295 election made by a domestic pass through entity does not apply to other stock of the PFIC held directly or indirectly by the interest holder or beneficiary.

(iii) *Effect of partnership termination on section 1295 election.* Termination of a section 1295 election made by a domestic partnership by reason of the termination of the partnership under section 708(b) will not terminate the section 1295 election with respect to partners of the terminated partnership that are partners of the new partnership. Except as otherwise provided, the stock of the PFIC of which the new partners are indirect shareholders will be treated as stock of a QEF only if the new domestic partnership makes a section 1295 election with respect to that stock.

(iv) *Characterization of stock held through a pass through entity.* Stock of a PFIC held through a pass through entity will be treated as stock of a pedigreed QEF with respect to an interest holder or beneficiary only if—

(A) In the case of PFIC stock acquired (other than in a transaction in which gain is not recognized pursuant to regulations under section 1291(f) with respect to that stock), and held by a domestic pass through entity, the pass through entity makes the section 1295 election and the PFIC has been a QEF with respect to the pass through entity for all taxable years that are included wholly or partly in the pass through entity's holding period of the PFIC stock and during which the foreign corporation was a PFIC within the meaning of § 1.1291–9(j)(1); or

(B) In the case of PFIC stock transferred by an interest holder or beneficiary to a pass through entity in a transaction in which gain is not recognized pursuant to regulations under section 1291(f) with respect to that stock and held by the pass through entity, the PFIC stock transferred to the pass through entity was treated as stock of a pedigreed QEF with respect to the interest holder or beneficiary at the time of the transfer and the pass through entity makes a section 1295 election.

(4) *Application of general rules to a taxpayer filing a joint return under section 6013.* A section 1295 election made by a taxpayer in a joint return, within the meaning of section 6013, will be treated as also made by the spouse that joins in the filing of that return.

(c) *Effect of section 1295 election*—(1) *In general.* Except as otherwise provided in this paragraph (c), the effect of a shareholder's section 1295 election is to treat the foreign corporation as a QEF with respect to the shareholder for each taxable year of the foreign corporation ending with or within a taxable year of the shareholder for which the election is effective. A section 1295 election is effective for the shareholder's election year and all subsequent taxable years of the shareholder unless invalidated, terminated or revoked as provided in paragraph (i) of this section. The terms shareholder and shareholder's election year are defined in paragraph (j) of this section.

(2) *Years to which section 1295 election applies*—(i) *In general.* Except as otherwise provided in this paragraph (c), a foreign corporation with respect to which a section 1295 election is made will be treated as a QEF for its taxable year ending with or within the shareholder's election year and all subsequent taxable years of the foreign corporation that are included wholly or partly in the shareholder's holding period (or periods) of stock of the foreign corporation.

(ii) *Effect of PFIC status on election.* A foreign corporation will not be treated as a QEF for any taxable year of the foreign corporation that the foreign corporation is not a PFIC under section 1296(a) and is not treated as a PFIC under section 1297(b)(1). However, cessation of a foreign corporation's status as a PFIC will not terminate a section 1295 election.

(iii) *Effect on election of complete termination of a shareholder's interest in the PFIC.* Complete termination of a shareholder's direct and indirect interest in stock of a foreign corporation will not terminate a shareholder's section 1295 election with respect to the foreign corporation.

(iv) *Effect on section 1295 election of transfer of stock to a domestic pass through entity.* The transfer of a shareholder's direct or indirect interest in stock of a foreign corporation to a domestic pass through entity (as defined in paragraph (j) of this section) will not terminate the shareholder's section 1295 election with respect to the foreign corporation, whether or not the pass through entity makes a section 1295 election. For the rules concerning the application of section 1293 to stock transferred to a domestic pass through entity, see § 1.1293–1T(c).

(v) *Examples.* The following examples illustrate the rules of this paragraph (c)(2).

Example 1. In 1998, C, a U.S. person, purchased stock of FC, a foreign corporation that is a PFIC. Both FC and C are calendar year taxpayers. C made a timely section 1295 election to treat FC as a QEF in C's 1998 return, and FC was therefore a pedigreed QEF. C included its shares of FC's 1998 ordinary earnings and net capital gain in C's 1998 income and did not make a section 1294 election to defer the time for payment of tax on that income. In 1999, 2000, and 2001, FC did not satisfy either the income or asset test of section 1296(a), and therefore was neither a PFIC nor a QEF. C therefore did not have to include its pro rata shares of the ordinary earnings and net capital gain of FC pursuant to section 1293, or satisfy the section 1295 annual reporting requirements for any of those years. FC qualified as a PFIC again in 2002. Because C had made a section 1295 election in 1998, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remains in effect for 2002. C therefore is subject in 2002 to the income inclusion and reporting rules required of shareholders of QEFs.

Example 2. The facts are the same as in Example (1) except that FC did not lose PFIC status in any year and C sold all the FC stock in 1999 and repurchased stock of FC in 2002. Because C had made a section 1295 election in 1998 with respect to stock of FC, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remained in effect and therefore applies to the stock

of FC purchased by C in 2002. C therefore is subject in 2002 to the income inclusion and reporting rules required of shareholders of QEFs.

Example 3. The facts are the same as in Example (2) except that C is a partner in domestic partnership P and C transferred its FC stock to P in 1999. Because C had made a section 1295 election in 1998 with respect to stock of FC, and the election had not been invalidated, terminated, or revoked, within the meaning of paragraph (i) of this section, C's section 1295 election remains in effect with respect to its indirect interest in the stock of FC. If P does not make the section 1295 election with respect to the FC stock, C will continue to be subject, in C's capacity as an indirect shareholder of FC, to the income inclusion and reporting rules required of shareholders of QEFs in 1999 and subsequent years. If P makes the section 1295 election, C will take into account its pro rata shares of the ordinary earnings and net capital gain of the FC under the rules applicable to inclusions of income from P.

(d) *Who may make a section 1295 election*—(1) *General rule.* Except as otherwise provided in this paragraph (d), any U.S. person that is a shareholder (as defined in paragraph (j) of this section) of a PFIC, including a shareholder that holds stock of a PFIC in bearer form, may make a section 1295 election with respect to that PFIC. The shareholder need not own directly or indirectly any stock of the PFIC at the time the shareholder makes the section 1295 election provided the shareholder is a shareholder of the PFIC during the taxable year of the PFIC that ends with or within the taxable year of the shareholder for which the section 1295 election is made. Except in the case of a shareholder that is an exempt organization that may not make a section 1295 election, as provided in paragraph (d)(5) of this section, in a chain of ownership only the first U.S. person that is a shareholder of the PFIC may make the section 1295 election.

(2) *Application of general rule to pass through entities*—(i) *Partnerships*—(A) *Domestic partnership.* A domestic partnership that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The partnership election applies only to the stock of the PFIC held directly or indirectly by the partnership and not to any other stock held directly or indirectly by any partner. As provided in § 1.1293–1T(c)(1), shareholders owning stock of a QEF by reason of an interest in the partnership take into account the section 1293 inclusions with respect to the QEF shares owned by the partnership under the rules applicable to inclusions of income from the partnership.

(B) *Foreign partnership.* A U.S. person that holds an interest in a foreign partnership that, in turn, holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. A partner's election applies to the stock of the PFIC owned directly or indirectly by the foreign partnership and to any other stock of the PFIC owned by that partner. A section 1295 election by a partner applies only to that partner.

(ii) *S corporation.* An S corporation that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The S corporation election applies only to the stock of the PFIC held directly or indirectly by the S corporation and not to any other stock held directly or indirectly by any S corporation shareholder. As provided in § 1.1293–1T(c)(1), shareholders owning stock of a QEF by reason of an interest in the S corporation take into account the section 1293 inclusions with respect to the QEF shares under the rules applicable to inclusions of income from the S corporation.

(iii) *Trust or estate*—(A) *Domestic trust or estate*—(*1*) *Nongrantor trust or estate.* A domestic nongrantor trust or a domestic estate that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. The trust or estate's election applies only to the stock of the PFIC held directly or indirectly by the trust or estate and not to any other stock held directly or indirectly by any beneficiary. As provided in § 1.1293–1T(c)(1), shareholders owning stock of a QEF by reason of an interest in a domestic trust or estate take into account the section 1293 inclusions with respect to the QEF shares under the rules applicable to inclusions of income from the trust or estate.

(*2*) *Grantor trust.* A U.S. person that is treated under sections 671 through 678 as the owner of the portion of a domestic trust that owns an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. If that person ceases to be treated as the owner of the portion of the trust that owns an interest in the PFIC stock and is a beneficiary of the trust, that person's section 1295 election will continue to apply to the PFIC stock indirectly owned by that person under the rules of paragraph (c)(2)(iv) of this section as if the person had transferred its interest in the PFIC stock to the trust. However, the stock will be treated as stock of a PFIC that is not a QEF with respect to other beneficiaries of the trust, unless the trust makes the section 1295 election as provided in paragraph (d)(2)(iii)(A)(1) of this section.

(B) *Foreign trust or estate*—(1) *Nongrantor trust or estate.* A U.S. person that is a beneficiary of a foreign nongrantor trust or estate that holds an interest in stock of a PFIC makes the section 1295 election with respect to that PFIC. A beneficiary's section 1295 election applies to all the PFIC stock owned directly and indirectly by the trust or estate and to the other PFIC stock owned directly or indirectly by the beneficiary. A section 1295 election by a beneficiary applies only to that beneficiary.

(*2*) *Grantor trust.* A U.S. person that is treated under sections 671 through 679 as the owner of the portion of a foreign trust that owns an interest in stock of a PFIC stock makes the section 1295 election with respect to that PFIC. If that person ceases to be treated as the owner of the portion of the trust that owns an interest in the PFIC stock and is a beneficiary of the trust, that person's section 1295 election will continue to apply to the PFIC stock indirectly owned by that person under the rules of paragraph (c)(2)(iv) of this section. However, as provided in paragraph (d)(2)(iii)(B)(1) of this section, any other shareholder that is a beneficiary of the trust and that wishes to treat the PFIC as a QEF must make the section 1295 election.

(iv) *Indirect ownership of the pass through entity or the PFIC.* The rules of this paragraph (d)(2) apply whether or not the shareholder holds its interest in the pass through entity directly or indirectly and whether or not the pass through entity holds its interest in the PFIC directly or indirectly.

(3) *Member of consolidated return group as shareholder.* Pursuant to § 1.1502–77(a), the common parent of an affiliated group of corporations that join in filing a consolidated income tax return makes a section 1295 election for all members of the affiliated group. An election by a common parent will be effective for all members of the affiliated group with respect to interests in PFIC stock

held at the time the election is made or at any time thereafter. A separate election must be made by the common parent for each PFIC of which a member of the affiliated group is a shareholder.

(4) *Option holder.* A holder of an option to acquire stock of a PFIC may not make a section 1295 election that will apply to the option or to the stock subject to the option.

(5) *Exempt organization.* A tax-exempt organization that is not taxable under section 1291, pursuant to § 1.1291–1T(e), with respect to a PFIC may not make a section 1295 election with respect to that PFIC. In addition, such an exempt organization will not be subject to any section 1295 election made by a domestic pass through entity.

(e) *Time for making a section 1295 election.* Except as provided in § 1.1295–3T, a shareholder making the section 1295 election must make the election on or before the due date, as extended under section 6081 (election due date), for filing the shareholder's income tax return for the first taxable year to which the election will apply. The section 1295 election must be made in the original return for that year, or in an amended return, provided the amended return is filed on or before the election due date.

(f) *Manner of making a section 1295 election and the annual election requirements of the shareholder*—(1) *Manner of making the election.* A shareholder must make a section 1295 election by—

(i) Completing Form 8621 in the manner required by that form and this section for making the section 1295 election;

(ii) Attaching Form 8621 to its federal income tax return filed by the election due date for the shareholder's election year;

(iii) Receiving and reflecting in Form 8621 the information provided in the PFIC Annual Information Statement described in paragraph (g)(1) of this section, the Annual Intermediary Statement described in paragraph (g)(3) of this section, or the applicable combined statement described in paragraph (g)(4) of this section, for the taxable year of the PFIC ending with or within the taxable year for which Form 8621 is being filed. If the PFIC Annual Information Statement contains a statement described in paragraph (g)(1)(ii)(C) of this section, the shareholder must attach a statement to Form 8621 that indicates that the shareholder rather than the QEF calculated the QEF's ordinary earnings and net capital gain; and

(iv) Filing a copy of Form 8621 with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114 by the election due date.

(2) *Annual election requirements*—(i) *In general.* A shareholder that makes a section 1295 election with respect to a PFIC held directly or indirectly, for each taxable year to which the section 1295 election applies, must—

(A) Complete Form 8621 in the manner required by that form and this section;

(B) Attach Form 8621 to its federal income tax return filed by the due date of the return, as extended;

(C) Receive and reflect in Form 8621 the PFIC Annual Information Statement described in paragraph (g)(1) of this section, the Annual Intermediary Statement described in paragraph (g)(3) of this section, or the applicable combined statement described in paragraph (g)(4) of this section, for the taxable year of the PFIC ending with or within the taxable year for which Form 8621 is being filed. If the PFIC Annual Information Statement contains a statement described in paragraph (g)(1)(ii)(C) of this section, the shareholder must attach a statement to its Form 8621 that the shareholder rather than the PFIC provided the calculations of the PFIC's ordinary earnings and net capital gain; and

(D) File a copy of Form 8621 with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114 by the election due date.

(ii) *Retention of documents.* For all taxable years subject to the section 1295 election, the shareholder must retain copies of all Forms 8621, with their attachments, and PFIC Annual Information Statements or Annual Intermediary Statements. Failure to produce those documents at the request of the Commissioner in connection with an examination may result in invalidation or termination of the shareholder's section 1295 election.

(g) *Annual election requirements of the PFIC or intermediary*—(1) *PFIC Annual Information Statement.* For each year of the PFIC ending in a taxable year of a shareholder to which the shareholder's section 1295 election applies, the PFIC must provide the shareholder with a PFIC Annual Information Statement. The PFIC Annual Information Statement is a statement of the PFIC, signed by the PFIC or an authorized representative of the PFIC, that contains the following information and representation—

(i) The first and last days of the taxable year of the PFIC to which the PFIC Annual Information Statement applies;

(ii) Either—

(A) The shareholder's pro rata shares of the ordinary earnings and net capital gain (as defined in § 1.1293–1T(a)(2)) of the PFIC for the taxable year indicated in paragraph (g)(1)(i) of this section; or

(B) Sufficient information to enable the shareholder to calculate its pro rata shares of the PFIC's ordinary earnings and net capital gain, for that taxable year; or

(C) A statement that the foreign corporation has permitted the shareholder to examine the books of account, records, and other documents of the foreign corporation for the shareholder to calculate the amounts of the PFIC's ordinary earnings and the net capital gain according to federal income tax accounting principles and to calculate the shareholder's pro rata shares of the PFIC's ordinary earnings and net capital gain;

(iii) The amount of cash and the fair market value of other property distributed or deemed distributed to the shareholder during the taxable year of the PFIC to which the PFIC Annual Information Statement pertains; and

(iv) Either—

(A) A statement that the PFIC will permit the shareholder to inspect and copy the PFIC's permanent books of account, records, and such other documents as may be maintained by the PFIC to establish that the PFIC's ordinary earnings and net capital gain are computed in accordance with U.S. income tax principles, and to verify these amounts and the shareholder's pro rata shares thereof; or

(B) In lieu of the statement required in paragraph (g)(1)(iv)(A) of this section, a description of the alternative documentation requirements approved by the Commissioner, with a copy of the private letter ruling and the closing agreement entered into by the Commissioner and the PFIC pursuant to paragraph (g)(2) of this section.

(2) *Alternative documentation.* In rare and unusual circumstances, the Commis-

sioner will consider alternative documentation requirements necessary to verify the ordinary earnings and net capital gain of a PFIC other than the documentation requirements described in paragraph (g)(1)(iv)(A) of this section. Alternative documentation requirements will be allowed only pursuant to a private letter ruling and a closing agreement entered into by the Commissioner and the PFIC describing an alternative method of verifying the PFIC's ordinary earnings and net capital gain. If the PFIC has not obtained a private letter ruling from the Commissioner approving an alternative method of verifying the PFIC's ordinary earnings and net capital gain by the time a shareholder is required to make a section 1295 election, the shareholder may not use an alternative method for that taxable year.

(3) *Annual Intermediary Statement.* In the case of a U.S. person that is a shareholder of a PFIC through an intermediary, as defined in paragraph (j) of this section, an Annual Intermediary Statement issued by an intermediary containing the information described in paragraph (g)(1) of this section and reporting the indirect owner's pro rata shares of the ordinary earnings and net capital gain of the QEF as described in paragraph (g)(1)(ii)(A) of this section, may be provided to the indirect owner in lieu of the PFIC Annual Information Statement if the following conditions are satisfied—

(i) The intermediary receives a copy of the PFIC Annual Information Statement or the intermediary receives an annual intermediary statement from another intermediary which contains a statement that the other intermediary has received a copy of the PFIC Annual Information Statement and represents that the conditions of paragraphs (g)(3)(ii) and (g)(3)(iii) of this section are met;

(ii) The representations and information contained in the Annual Intermediary Statement reflect the representations and information contained in the PFIC Annual Information Statement; and

(iii) The PFIC Annual Information Statement issued to the intermediary contains either the representation set forth in paragraph (g)(1)(iv)(A) of this section, or, if alternative documentation requirements were approved by the Commissioner pursuant to paragraph (g)(2) of this section, a copy of the private letter ruling and closing agreement between the Commissioner and the PFIC, agreeing to an alternative method of verifying PFIC ordinary earnings and net capital gain as described in paragraph (g)(2) of this section;

(4) *Combined statements*—(i) *PFIC Annual Information Statement.* A PFIC that owns directly or indirectly any stock of one or more PFICs with respect to which a shareholder may make the section 1295 election may prepare a PFIC Annual Information Statement that combines with its own information and representations the information and representations of all the PFICs. The PFIC may use any format for a combined PFIC Annual Information Statement provided the required information and representations are separately stated and identified with the respective corporations.

(ii) *Annual Intermediary Statement.* An intermediary described in paragraph (g)(3) of this section that owns directly or indirectly stock of one or more PFICs with respect to which an indirect shareholder may make the section 1295 election may prepare an Annual Intermediary Statement that combines with its own information and representations the information and representations with respect to all the PFICs. The intermediary may use any format for a combined Annual Intermediary Statement provided the required information and representations are separately stated and identified with the intermediary and the respective corporations.

(h) *Transition rules.* The rules of Notice 88–125, 1988–2 C.B. 535 (see § 601.601(d)(2)(ii)(b) of this chapter), apply for making elections and maintaining elections for taxable years beginning after December 31, 1986, and before January 1, 1998. Elections made under Notice 88–125 must be maintained as provided in § 1.1295–1T for taxable years beginning after December 31, 1997. A section 1295 election made prior to February 1, 1998, that was intended to be effective for the taxable year of the PFIC that began during the shareholder's election year will be effective for that taxable year of the foreign corporation provided that it is clear from all the facts and circumstances that the shareholder intended the election to be effective for that taxable year of the foreign corporation.

(i) *Invalidation, termination, or revocation of section 1295 election*—(1) *Invalidation or termination of election at the discretion of the Commissioner*—(i) *In general.* The Commissioner, in the Commissioner's discretion, may invalidate or terminate a section 1295 election applicable to a shareholder if the shareholder, the PFIC, or any intermediary fails to satisfy the requirements for making a section 1295 election or the annual election requirements of this section to which the shareholder, PFIC, or intermediary is subject, including the requirement to provide, on request, copies of the books and records of the PFIC or other documentation substantiating the ordinary earnings and net capital gain of the PFIC.

(ii) *Deferral of section 1293 inclusion.* The Commissioner may invalidate any pass through entity section 1295 election with respect to an interest holder or beneficiary if the section 1293 inclusion with respect to that interest holder or beneficiary is not included in the gross income of either the pass through entity, an intermediate pass through entity, or the interest holder or beneficiary within two years of the end of the PFIC's taxable year due to nonconforming taxable years of the interest holder and the pass through entity or any intermediate pass through entity.

(iii) *When effective.* Termination of a shareholder's section 1295 election will be effective for the taxable year of the PFIC determined by the Commissioner in the Commissioner's discretion. An invalidation of a shareholder's section 1295 election will be effective for the first taxable year to which the section 1295 election applied, and the shareholder whose election is invalidated will be treated as if the section 1295 election never was made.

(2) *Shareholder revocation*—(i) *In general.* In the Commissioner's discretion, upon a finding of a substantial change in circumstances, the Commissioner may consent to a shareholder's request to revoke a section 1295 election. Request for revocation must be made by the shareholder that made the election and at the time and in the manner provided in paragraph (i)(2)(ii) of this section.

(ii) *Time for and manner of requesting consent to revoke*—(A) *Time.* The shareholder must request consent to revoke the section 1295 election no later than 12 calendar months after the discovery of the substantial change of circumstances that

forms the basis for the shareholder's request to revoke the section 1295 election.

(B) *Manner of making request.* A shareholder requests consent to revoke a section 1295 election by filing a ruling request with the Office of the Associate Chief Counsel (International). The ruling request must satisfy the requirements, including payment of the user fee, for filing ruling requests with that office.

(iii) *When effective.* Unless otherwise determined by the Commissioner, revocation of a section 1295 election will be effective for the first taxable year of the PFIC beginning after the date the Commissioner consents to the revocation.

(3) *Effect of invalidation, termination, or revocation.* An invalidation, termination, or revocation of a section 1295 election—

(i) Terminates all section 1294 elections, as provided in § 1.1294–1T(e), and the undistributed PFIC earnings tax liability and interest thereon are due by the due date, without regard to extensions, for the return for the last taxable year of the shareholder to which the section 1295 election applies;

(ii) In the Commissioner's discretion, results in a deemed sale of the QEF stock on the last day of the PFIC's last taxable year as a QEF, in which gain, but not loss, will be recognized and with respect to which appropriate basis and holding period adjustments will be made; and

(iii) Subjects the shareholder to any other terms and conditions that the Commissioner determines are necessary to ensure the shareholder's compliance with sections 1291 through 1297 or any other provisions of the Code.

(4) *Election after invalidation, termination, or revocation.* Without the Commissioner's consent a shareholder whose section 1295 election was invalidated, terminated, or revoked under this paragraph (i) may not make the section 1295 election with respect to the PFIC before the sixth taxable year ending after the taxable year in which the invalidation, termination, or revocation became effective.

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

Intermediary is a nominee or shareholder of record that holds stock on behalf of the shareholder or on behalf of another person in a chain of ownership between the shareholder and the PFIC, and any direct or indirect beneficial owner of PFIC stock (including a beneficial owner that is a pass through entity) in the chain of ownership between the shareholder and the PFIC.

Pass through entity is a partnership, S corporation, trust, or estate.

Shareholder has the same meaning as the term shareholder in § 1.1291–9(j)(3), except that for purposes of this section, a partnership and an S corporation also are treated as shareholders. Furthermore, unless otherwise provided, an interest holder of a pass through entity, which is treated as a shareholder of a PFIC, also will be treated as a shareholder of the PFIC.

Shareholder's election year is the taxable year of the shareholder for which it made the section 1295 election.

(k) *Effective date.* Section 1.1295–1T(b)(2)(iii), (b)(3), (b)(4), and (c) through (j) is applicable to taxable years of shareholders beginning after December 31, 1997.

Par. 12. Section 1.1295–3T is added to read as follows:

§ 1.1295–3T Retroactive elections (temporary).

(a) *In general.* This section prescribes the exclusive rules under which a shareholder, as defined in § 1.1295–1T(j), may make a section 1295 election for a taxable year after the election due date, as defined in § 1.1295–1T(e) (retroactive election). Therefore, a shareholder may not seek such relief under any other provision of the law, including § 301.9100 of this chapter. Paragraph (b) of this section describes the general rules for a shareholder to preserve the ability to make a retroactive election. These rules require that the shareholder possess reasonable belief as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended in the shareholder's taxable year to which the election due date pertains, and that the shareholder file a Protective Statement to preserve its ability to make a retroactive election. Paragraph (c) of this section establishes the terms, conditions and other requirements with respect to a Protective Statement required to be filed under the general rules. Paragraph (d) of this section sets forth factors that establish a shareholder's reasonable belief that a foreign corporation was not a PFIC. Paragraph (e) of this section prescribes special rules for certain shareholders that are deemed to satisfy the reasonable belief requirement and therefore are not required to file a Protective Statement. Paragraph (f) of this section describes the limited circumstances under which the Commissioner may permit a shareholder that lacked the requisite reasonable belief or failed to satisfy the requirements of paragraph (b) or (e) of this section to make a retroactive election. Paragraph (g) of this section provides the time for and manner of making a retroactive election. Paragraph (h) of this section provides the effective date of this section.

(b) *General rule.* Except as provided in paragraphs (e) and (f) of this section, a shareholder may make a retroactive election for a taxable year of the shareholder (retroactive election year) only if the shareholder—

(1) Reasonably believed, within the meaning of paragraph (d) of this section, as of the election due date that the foreign corporation was not a PFIC for its taxable year that ended during the retroactive election year;

(2) Filed a Protective Statement with respect to the foreign corporation, applicable to the retroactive election year, in which the shareholder described the basis for its reasonable belief and extended, in the manner provided in paragraph (c)(4) of this section, the periods of limitations on the assessment of taxes determined under sections 1291 through 1297 with respect to the foreign corporation (PFIC related taxes) for all taxable years of the shareholder to which the Protective Statement applies; and

(3) Complied with the other terms and conditions of the Protective Statement.

(c) *Protective Statement*—(1) *In general.* A Protective Statement is a statement executed under penalties of perjury by the shareholder, or a person authorized to sign a federal income tax return on behalf of the shareholder, that preserves the shareholder's ability to make a retroactive election. To file a Protective Statement that applies to a taxable year of the shareholder, the shareholder must reasonably believe as of the election due date that the foreign corporation was not a PFIC for the foreign corporation's taxable year that ended during the retroactive election year. The Protective Statement must contain—

(i) The shareholder's reasonable belief statement, as described in paragraph (c)(2) of this section;

(ii) The shareholder's agreement extending the periods of limitations on the assessment of PFIC related taxes for all taxable years to which the Protective Statement applies, as provided in paragraph (c)(4) of this section; and

(iii) The following information and representations—

(A) The shareholder's name, address, taxpayer identification number, and the shareholder's first taxable year to which the Protective Statement applies;

(B) The foreign corporation's name, address, and taxpayer identification number, if any; and

(C) The highest percentage of shares of each class of stock of the foreign corporation held directly or indirectly by the shareholder during the shareholder's first taxable year to which the Protective Statement applies.

(2) *Reasonable belief statement.* The Protective Statement must contain a reasonable belief statement, as described in paragraph (c)(1) of this section. The reasonable belief statement is a description of the shareholder's basis for its reasonable belief that the foreign corporation was not a PFIC for its taxable year that ended with or within the shareholder's first taxable year to which the Protective Statement applies. If the Protective Statement applies to a taxable year or years described in paragraph (c)(5)(ii) of this section, the reasonable belief statement must describe the shareholder's basis for its reasonable belief that the foreign corporation was not a PFIC for the foreign corporation's taxable year or years that ended in such taxable year or years of the shareholder. The reasonable belief statement must discuss the application of the income and asset tests to the foreign corporation and the factors, including those stated in paragraph (d) of this section, that affect the results of those tests.

(3) *Who executes and files the Protective Statement.* The person that executes and files the Protective Statement is the person that makes the section 1295 election, as provided in § 1.1295–1T(d).

(4) *Waiver of the periods of limitations*—(i) *Time for and manner of extending periods of limitations.* (A) *In general.* A shareholder that files the Protective Statement with the Commissioner must extend the periods of limitations on the assessment of all PFIC related taxes for all of the shareholder's taxable years to which the Protective Statement applies, as provided in this paragraph (c)(4). The shareholder is required to execute the waiver on such form as the Commissioner may prescribe for purposes of this paragraph (c)(4). Until that form is published, the shareholder must execute a statement in which the shareholder agrees to extend the periods of limitations on the assessment of taxes for all the shareholder's taxable years to which the Protective Statement applies, as provided in this paragraph (c)(4), and agrees to the restrictions in paragraph (c)(4)(ii)(A) of this section. The shareholder or a person authorized to sign the shareholder's federal income tax return must sign the form or statement. A properly executed form or statement authorized by this paragraph (c)(4) will be deemed consented to and signed by a Service Center Director or the Assistant Commissioner (International) for purposes of § 301.6501(c)–1(d) of this chapter.

(B) *Application of general rule to domestic partnerships—(1) In general.* A domestic partnership that holds an interest in stock of a PFIC satisfies the waiver requirement of paragraph (c)(4) of this section pursuant to the rules of this paragraph (c)(4)(i)(B)(*1*). The partnership must file one or more waivers obtained or arranged under this paragraph (c)(4)(i)(B) as part of the Protective Statement, as provided in paragraph (c)(1) of this section. The partnership must either—

(*i*) Obtain from each partner the partner's waiver of the periods of limitations;

(*ii*) Obtain from each partner a duly executed power of attorney under § 601.501 of this chapter authorizing the partnership to extend that partner's periods of limitations, and execute a waiver on behalf of the partners; or

(*iii*) In the case of a domestic partnership governed by the unified audit and litigation procedures of sections 6221 through 6233 (TEFRA partnership), arrange for the tax matters partner (or any other person authorized to enter into an agreement to extend the periods of limitations), as provided in section 6229(b), to execute a waiver on behalf of all the partners.

(*2*) *Special rules—*(*i*) *Addition of partner to non-TEFRA partnership.* In the case of any individual who becomes a partner in a domestic partnership other than a TEFRA partnership (non-TEFRA partnership) in a taxable year subsequent to the year in which the partnership filed a Protective Statement, the partner and the partnership must comply with the rules applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(1) of this section, by the due date, as extended, for the federal income tax return of the partnership for the taxable year during which the individual became a partner. Failure to so comply will render the Protective Statement invalid with respect to the partnership and partners.

(*ii*) *Change in status from non-TEFRA partnership to TEFRA partnership.* If a partnership is a non-TEFRA partnership in one taxable year but becomes a TEFRA partnership in a subsequent taxable year, the partnership must file one or more waivers obtained or arranged under this paragraph (c)(4)(i)(B)(*2*)(*ii*), as part of the Protective Statement, as provided in paragraph (c)(1) of this section. The partnership must either obtain from any new partner the partner's waiver described in this paragraph (c)(4); obtain from the new partner a duly executed power of attorney under § 601.501 of this chapter authorizing the partnership to extend the partner's periods of limitations, and execute a waiver on behalf of the new partner; or arrange for the tax matters partner (or any other person authorized to enter into an agreement to extend the periods of limitations) to execute a waiver on behalf of all the partners. In each case, the partnership must attach any new waiver of a partner's periods of limitations, and a copy of the Protective Statement to its federal income tax return for that taxable year.

(C) *Application of general rule to domestic nongrantor trusts and domestic estates.* A domestic nongrantor trust or a domestic estate that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph (c)(4) at the entity level. For this purpose, such entity must comply with rules similar to those applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(*1*) of this section.

(D) *Application of general rule to S corporations.* An S corporation that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph

(c)(4) at the S corporation level. For this purpose, the S corporation must comply with rules similar to those applicable to non-TEFRA partnerships, as provided in paragraph (c)(4)(i)(B)(*1*) of this section. However, in the case of an S corporation that was governed by the unified audit corporate proceedings of sections 6241 through 6245 for any taxable year to which a Protective Statement applies (former TEFRA S corporation), the tax matters person (or any other person authorized to enter into such an agreement), as was provided in sections 6241 through 6245, may execute a waiver described in this paragraph (c)(4) that applies to such taxable year; for any other taxable year, the former TEFRA S corporation must comply with rules similar to those applicable to non-TEFRA partnerships.

(E) *Effect on waiver of complete termination of a pass through entity or pass through entity's business.* The complete termination of a pass through entity described in paragraphs (c)(4)(i)(B) through (D) of this section, or a pass through entity's trade or business, will not terminate a waiver that applies to a partner, shareholder, or beneficiary.

(F) *Application of general rule to foreign partnerships, foreign trusts, domestic or foreign grantor trusts, and foreign estates.* A U.S. person that is a partner or beneficiary of a foreign partnership, foreign trust, or foreign estate that holds an interest in stock of a PFIC satisfies the waiver requirement of this paragraph (c)(4) at the partner or beneficiary level. A U.S. person that is treated under sections 671 through 679 as the owner of the portion of a domestic or foreign trust that owns an interest in PFIC stock also satisfies the waiver requirement at the owner level. A waiver by a partner or beneficiary applies only to that partner or beneficiary, and is not affected by a complete termination of the entity or the entity's trade or business.

(ii) *Terms of waiver*—(A) *Scope of waiver.* The waiver of the periods of limitations is limited to the assessment of PFIC related taxes. If the period of limitations for a taxable year affected by a retroactive election has expired with respect to the assessment of other non-PFIC related taxes, no adjustments, other than consequential changes, may be made by the Internal Revenue Service or by the shareholder to any other items of income, deduction, or credit for that year. If the period of limitations for refunds or credits for a taxable year affected bya retroactive election is open only by virtue of the assessment period extension and section 6511(c), no refund or credit is allowable on grounds other than adjustments to PFIC related taxes and consequential changes.

(B) *Period of waiver.* The extension of the periods of limitations on the assessment of PFIC related taxes will be effective for all of the shareholder's taxable years to which the Protective Statement applies. In addition, the waiver, to the extent it applies to the period of limitations for a particular year, will terminate with respect to that year no sooner than three years from the date on which the shareholder files an amended return, as provided in paragraph (g) of this section, for that year. For the suspension of the running of the period of limitations for the collection of taxes for which a shareholder has elected under section 1294 to extend the time for payment, as provided in paragraph (g)(3)(ii) of this section, see sections 6503(i) and 6229(h).

(5) *Time for and manner of filing a Protective Statement*—(i) *In general.* Except as provided in paragraph (c)(5)(ii) of this section, a Protective Statement must be attached to the shareholder's federal income tax return for the shareholder's first taxable year to which the Protective Statement will apply. The shareholder also must file a copy of the Protective Statement with the Philadelphia Service Center, P.O. 21086, Philadelphia, PA 19114. The shareholder must file its return and the copy of the Protective Statement by the due date, as extended, for the return.

(ii) *Special rule for taxable years ended before January 2, 1998.* A shareholder may file a Protective Statement that applies to the shareholder's taxable year or years that ended before January 2, 1998, provided the period of limitations on the assessment of taxes for any such year has not expired (open year). The shareholder must file the Protective Statement applicable to such open year or years, as provided in paragraph (c)(5)(i) of this section, by the due date, as extended, for the shareholder's return for the first taxable year ending after January 2, 1998.

(6) *Applicability of the Protective Statement*—(i) *In general.* Except as otherwise provided in this paragraph (c)(6), a Protective Statement applies to the shareholder's first taxable year for which the Protective Statement was filed and to each subsequent taxable year. The Protective Statement will not apply to any taxable year of the shareholder during which the shareholder does not own any stock of the foreign corporation or to any taxable year thereafter. Accordingly, if the shareholder has not made a retroactive election with respect to the previously owned stock by the time the shareholder reacquires stock of the foreign corporation, the shareholder must file another Protective Statement to preserve its right to make a retroactive election with respect to the later acquired stock. For the rule that provides that a section 1295 election made with respect to a foreign corporation applies to stock of that corporation acquired after a lapse in ownership, see § 1.1295–1T(c)(2)(iii).

(ii) *Invalidity of the Protective Statement.* A shareholder will be treated as if it never filed a Protective Statement if—

(A) The shareholder failed to make a retroactive election by the date prescribed for making the retroactive election in paragraph (g)(1) of this section; or

(B) The waiver of the periods of limitations terminates (by reason of a court decision or other determination) with respect to any taxable year before the expiration of three years from the date of filing of an amended return for that year pursuant to paragraph (g) of this section.

(7) *Retention of Protective Statement and information demonstrating reasonable belief.* A shareholder that files a Protective Statement must retain a copy of the Protective Statement and its attachments and must, for each taxable year of the shareholder to which the Protective Statement applies, retain information sufficient to demonstrate the shareholder's reasonable belief that the foreign corporation was not a PFIC for the taxable year of the foreign corporation ending during each such taxable year of the shareholder.

(d) *Reasonable belief*—(1) *In general.* A foreign corporation is a PFIC for a taxable year if the foreign corporation satisfies either the income or asset test of section 1296(a). To determine whether a shareholder had reasonable belief that the

foreign corporation is not a PFIC under section 1296(a), the shareholder must consider all relevant facts and circumstances. Reasonable belief may be based on a variety of factors, including reasonable asset valuations as well as reasonable interpretations of the applicable provisions of the Code, regulations, and administrative guidance regarding the direct or indirect ownership of the income or assets of the foreign corporation, the proper character of that income or those assets, and similar issues. Reasonable belief may be based on reasonable predictions regarding income to be earned and assets to be owned in subsequent years where qualification of the foreign corporation as a PFIC for the current taxable year will depend on the qualification of the corporation as a PFIC in a subsequent year. Reasonable belief may be based on an analysis of generally available financial information of the foreign corporation. To determine whether a shareholder had reasonable belief that the foreign corporation was not a PFIC, the Commissioner may consider the size of the shareholder's interest in the foreign corporation.

(2) *Knowledge of law required.* Reasonable belief must be based on a good faith effort to apply the Code, regulations, and related administrative guidance. Any person's failure to know or apply these provisions will not form the basis of reasonable belief.

(e) *Special rules for qualified shareholders*—(1) *In general.* A shareholder that is a qualified shareholder, as defined in paragraph (e)(2) of this section, for a taxable year of the shareholder is not required to satisfy the reasonable belief requirement of paragraph (b)(1) of this section or file a Protective Statement to preserve its ability to make a retroactive election with respect to such taxable year. Accordingly, a qualified shareholder may make a retroactive election for any open taxable year in the shareholder's holding period. The retroactive election will be treated as made in the earliest taxable year of the shareholder during which the foreign corporation qualified as a PFIC (including a taxable year ending prior January 2, 1998) and the shareholder will be treated as a shareholder of a pedigreed QEF, as defined in § 1.1291–9(j)(2)(ii), provided the shareholder—

(i) Has been a qualified shareholder with respect to the foreign corporation for all taxable years of the shareholder included in the shareholder's holding period during which the foreign corporation was a PFIC, or in the case of taxable years ending before January 2, 1998, the shareholder satisfies the criteria of a qualified shareholder, for all such years; or

(ii) Has been a qualified shareholder, or in the case of taxable years ending before January 2, 1998, satisfies the criteria of a qualified shareholder, for all taxable years in its holding period before it filed a Protective Statement, which Protective Statement is applicable to all subsequent years, beginning with the first taxable year in which the shareholder is not a qualified shareholder.

(2) *Qualified shareholder.* A shareholder will be treated as a qualified shareholder for a taxable year if the shareholder did not file a Protective Statement applicable to an earlier taxable year included in the shareholder's holding period of the stock of the foreign corporation currently held and—

(i) At all times during the taxable year the shareholder owned, within the meaning of section 958, directly, indirectly, or constructively, less than two percent of the vote and value of each class of stock of the foreign corporation; and

(ii) With respect to the taxable year of the foreign corporation ending within the shareholder's taxable year, the foreign corporation or U.S. counsel for the foreign corporation indicated in a public filing, disclosure statement or other notice provided to U.S. persons that are shareholders of the foreign corporation (corporate filing) that the foreign corporation—

(A) Reasonably believes that it is not or should not constitute a PFIC for the corporation's taxable year; or

(B) Is unable to conclude that it is not or should not be a PFIC (due to certain asset valuation or interpretation issues, or because PFIC status will depend on the income or assets of the foreign corporation in the corporation's subsequent taxable years) but reasonably believes that, more likely than not, it ultimately will not be a PFIC.

(3) *Exceptions.* Notwithstanding paragraph (e)(2)(ii) of this section, a shareholder will not be treated as a qualified shareholder for a taxable year of the shareholder if the shareholder knew or had reason to know that a corporate filing regarding the foreign corporation's PFIC status was inaccurate, or knew that the foreign corporation was a PFIC for the taxable year of the foreign corporation ending with or within such taxable year of the shareholder. For purposes of this paragraph, a shareholder will be treated as knowing that a foreign corporation was a PFIC if the principal activity of the foreign corporation, directly or indirectly, is owning or trading a diversified portfolio of stock, securities, or other financial contracts.

(f) *Special consent*—(1) *In general.* A shareholder that has not satisfied the requirements of paragraph (b) or (e) of this section may request the consent of the Commissioner to make a retroactive election for a taxable year of the shareholder provided the shareholder satisfies the requirements set forth in this paragraph (f). The Commissioner will grant relief under this paragraph (f) only if—

(i) The shareholder reasonably relied on a qualified tax professional, within the meaning of paragraph (f)(2) of this section;

(ii) Granting consent will not prejudice the interests of the United States government, as provided in paragraph (f)(3) of this section;

(iii) The shareholder requests consent under paragraph (f) of this section before a representative of the Internal Revenue Service raises upon audit the PFIC status of the corporation for any taxable year of the shareholder; and

(iv) The shareholder satisfies the procedural requirements set forth in paragraph (f)(4) of this section.

(2) *Reasonable reliance on a qualified tax professional*—(i) *In general.* Except as provided in paragraph (f)(2)(ii) of this section, a shareholder is deemed to have reasonably relied on a qualified tax professional only if the shareholder reasonably relied on a qualified tax professional (including a tax professional employed by the shareholder) who failed to identify the foreign corporation as a PFIC or failed to advise the shareholder of the consequences of making, or failing to make, the section 1295 election. A shareholder will not be considered to have reasonably relied on a qualified tax professional if the

shareholder knew, or reasonably should have known, that the foreign corporation was a PFIC and the availability of a section 1295 election, or knew or reasonably should have known that the qualified tax professional—

(A) Was not competent to render tax advice with respect to the ownership of shares of a foreign corporation; or

(B) Did not have access to all relevant facts and circumstances.

(ii) *Shareholder deemed to have not reasonably relied on a qualified tax professional.* For purposes of this paragraph (f)(2), a shareholder is deemed to have not reasonably relied on a qualified tax professional if the shareholder was informed by the qualified tax professional that the foreign corporation was a PFIC and of the availability of the section 1295 election and related tax consequences, but either chose not to make the section 1295 election or was unable to make a valid section 1295 election.

(3) *Prejudice to the interests of the United States government*—(i) *General rule.* Except as otherwise provided in paragraph (f)(3)(ii) of this section, the Commissioner will not grant consent under paragraph (f) of this section if doing so would prejudice the interests of the United States government. The interests of the United States government are prejudiced if granting relief would result in the shareholder having a lower tax liability, taking into account applicable interest charges, in the aggregate for all years affected by the retroactive election (other than by a de minimis amount) than the shareholder would have had if the shareholder had made the section 1295 election by the election due date. The time value of money is taken into account for purposes of this computation.

(ii) *Elimination of prejudice to the interests of the United States government.* Notwithstanding the general rule of paragraph (f)(3)(i) of this section, if granting relief would prejudice the interests of the United States government, the Commissioner may, in the Commissioner's sole discretion, grant consent to make the election provided the shareholder enters into a closing agreement with the Commissioner that requires the shareholder to pay an amount sufficient to eliminate any prejudice to the United States government as a consequence of the shareholder's inability to file amended returns for closed taxable years.

(4) *Procedural requirements*—(i) *Filing instructions.* A shareholder requests consent under paragraph (f) of this section to make a retroactive election by filing with the Office of the Associate Chief Counsel (International) a ruling request that includes the affidavits required by this paragraph (f)(4). The ruling request must satisfy the requirements, including payment of the user fee, for ruling requests filed with that office.

(ii) *Affidavit from shareholder.* The shareholder, or a person authorized to sign a federal income tax return on behalf of the shareholder, must submit a detailed affidavit describing the events that led to the failure to make a section 1295 election by the election due date, and to the discovery thereof. The shareholder's affidavit must describe the engagement and responsibilities of the qualified tax professional as well as the extent to which the shareholder relied on the tax professional. The shareholder must sign the affidavit under penalties of perjury. An individual who signs for an entity must have personal knowledge of the facts and circumstances at issue.

(iii) *Affidavits from other persons.* The shareholder must submit detailed affidavits from individuals having knowledge or information about the events that led to the failure to make a section 1295 election by the election due date, and to the discovery thereof. These individuals must include the qualified tax professional upon whose advice the shareholder relied, as well as any individual (including an employee of the shareholder) who made a substantial contribution to the return's preparation, and any accountant or attorney, knowledgeable in tax matters, who advised the shareholder with regard to its ownership of the stock of the foreign corporation. Each affidavit must describe the individual's engagement and responsibilities as well as the advice concerning the tax treatment of the foreign corporation that the individual provided to the shareholder. Each affidavit also must include the individual's name, address, and taxpayer identification number, and must be signed by the individual under penalties of perjury.

(iv) *Other information.* In connection with a request for consent under this paragraph (f), a shareholder must provide any additional information requested by the Commissioner.

(v) *Notification of Internal Revenue Service.* The shareholder must notify the branch of the Associate Chief Counsel (International) considering the request for relief under this paragraph (f) if, while the shareholder's request for consent is pending, the Internal Revenue Service begins an examination ofthe shareholder's return for the retroactive election year or for any subsequent taxable year during which the shareholder holds stock of the foreign corporation.

(vi) *Who requests special consent under this paragraph (f) and who enters into a closing agreement.* The person that requests consent under this paragraph (f) is the person that makes the section 1295 election, as provided in § 1.1295–1T(d). If a shareholder is required to enter into a closing agreement with the Commissioner, as described in paragraph (f)(3)(ii) of this section, rules similar to those under paragraphs (c)(4)(i)(B) through (E) of this section apply for purposes of determining the person that enters into the closing agreement.

(g) *Time for and manner of making a retroactive election*—(1) *Time for making a retroactive election*—(i) *In general.* Except as otherwise provided in paragraph (g)(1)(ii) of this section, a shareholder must make a retroactive election, in the manner provided in paragraph (g)(2) of this section, on or before the due date, as extended, for the shareholder's return—

(A) In the case of a shareholder that makes a retroactive election pursuant to paragraph (b) or (e) of this section, for the taxable year in which the shareholder determines or reasonably should have determined that the foreign corporation was a PFIC; or

(B) In the case of a shareholder that obtains the consent of the Commissioner pursuant to paragraph (f) of this section,for the taxable year in which such consent is granted.

(ii) *Transition rule.* A shareholder that files a Protective Statement for a taxable year described in paragraph (c)(5)(ii) of this section may make a retroactive election by the due date, as extended, for the return for the first taxable year ended after January 2, 1998, even if the shareholder

determined or should have determined that the foreign corporation was a PFIC for a year described in paragraph (c)(5)(ii) of this section at any time on or before January 2, 1998.

(iii) *Ownership not required at time retroactive election is made.* The shareholder need not own shares of the foreign corporation at the time the shareholder makes a retroactive election with respect to the foreign corporation.

(2) *Manner of making a retroactive election.* A shareholder that has satisfied the requirements of paragraph (b) or (e) of this section, or a shareholder that has been granted consent under paragraph (f) of this section, must make a retroactive election in the manner provided in Form 8621 for making a section 1295 election, and must attach Form 8621 to an amended return for the later of the retroactive election year or the earliest open taxable year of the shareholder. The shareholder also must file an amended return for each of its subsequent taxable years affected by the retroactive election. In each amended return the shareholder must redetermine its income tax liability for that year to take into account the assessment of PFIC related taxes. If the period of limitations for the assessment of taxes for a taxable year affected by the retroactive election has expired except to the extent the waiver of limitations, described in paragraph (c)(4) of this section, has extended such period, no adjustments, other than consequential changes, may be made to any other items of income, deduction, or credit in that year. In addition, the shareholder must pay all taxes and interest owing by reason of the PFIC and QEF status of the foreign corporation in those years (except to the extent a section 1294 election extends the time to pay the taxes and interest). A shareholder that filed a Protective Statement must attach to Form 8621 filed with each amended return a representation that the shareholder, until the taxable year in which it determined or reasonably should have determined that the foreign corporation was a PFIC, reasonably believed, within the meaning of paragraph (d) of this section, that the foreign corporation was not a PFIC in the taxable year for which the amended return is filed, and in all other taxable years to which the Protective Statement applies. A shareholder that entered into a closing agreement must comply with the terms of that agreement, as provided in paragraph (f)(3)(ii) of this section, to eliminate any prejudice to the United States government's interests, as described in paragraph (f)(3) of this section.

(3) *Who makes the retroactive election.* The person that makes the retroactive election is the person that makes the section 1295 election, as provided in § 1.1295–1T(d). A partner, shareholder, or beneficiary for which a pass through entity, as described in paragraphs (c)(4)(i)(B) through (D) of this section, filed a Protective Statement may make a retroactive election, if the pass through entity completely terminates its business or otherwise ceases to exist.

(4) *Other elections*—(i) *Section 1291(d)(2) election.* If the foreign corporation for which the shareholder makes a retroactive election will be treated as an unpedigreed QEF, as defined in § 1.1291–9(j)(2)(iii), with respect to the shareholder, the shareholder may make an election under section 1291(d)(2) to purge its holding period of the years or parts of years before the effective date of the retroactive election. If the qualification date, within the meaning of § 1.1291–9(e) or 1.1291–10(e), falls in a taxable year for which the period of limitations has expired, the shareholder may treat the first day of the retroactive election year as the qualification date. The shareholder may make a section 1291(d)(2) election at the time that it makes the retroactive election, but no later than two years after the date that the amended return in which the retroactive election is made is filed. For the requirements for making a section 1291(d)(2) election, see §§ 1.1291–9 and 1.1291–10.

(ii) *Section 1294 election.* A shareholder may make an election under section 1294 to extend the time for payment of tax on the shareholder's pro rata shares of the ordinary earnings and net capital gain of the foreign corporation reported in the shareholder's amended return, and section 6621 interest attributable to such tax, but only to the extent the tax and interest are attributable to earnings that have not been distributed to the shareholder. The shareholder must make a section 1294 election for a taxable year at the time that it files its amended return for that year, as provided in paragraph (g)(1) of this section. For the requirements for making a section 1294 election, see § 1.1294–1T.

(h) *Effective date.* The rules of this section are effective as of January 2, 1998.

Par. 13. Section 1.1297–3T(c) is added to read as follows:

§ 1.1297–3T Deemed sale election by a United States person that is a shareholder of a passive foreign investment company (temporary).

* * * * *

(c) *Application of deemed dividend election rules*—(1) *In general.* A shareholder of a former PFIC, within the meaning of § 1.1291–9(j)(2)(iv), that was a controlled foreign corporation, within the meaning of section 957(a) (CFC), during its last taxable year as a PFIC under section 1296(a), may apply the rules of section 1291(d)(2)(B) and § 1.1291–9 to an election under section 1297(b)(1) and this section made by the time and in the manner provided in paragraph (b) of this section.

(2) *Transition rule.* If the time for making an election under this section, as provided in paragraph (b) of this section, expired before January 2, 1998, a shareholder that applied rules similar to the rules of section 1291(d)(2)(A) and § 1.1291–10 to an election under this section made with respect to a corporation that was a CFC during its last taxable year as a PFIC under section 1296(a) may file an amended return for the taxable year that includes the termination date, as defined in paragraph (a) of this section, and apply the rules of section 1291(d)(2)(B) and § 1.1291–9 at any time before the expiration of the period of limitations for the assessment of taxes for that taxable year.

(3) *Effective date.* The rules of this paragraph are effective as of January 2, 1998.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 14. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

§602.101 [Amended]

Par. 15. In § 602.101, paragraph (c) is amended by adding entries in numerical order to the table to read as follows:

§ 602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB Control No.
* * * * *	
1.1295–1T	1545–1555
1.1295–3T	1545–1555
* * * * *	

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

Approved December 15, 1997.

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

(Filed by the Office of the Federal Register on December 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1998, 63 F.R. 6)

Section 4081.—Imposition of Tax

26 CFR 48.4081–1: Taxable fuel; definitions.

T.D. 8748

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 40 and 48

Gasoline and Diesel Fuel Excise Tax; Special Rules for Alaska; Definitions

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the application of the diesel fuel excise tax to fuel used in Alaska. This document also contains final regulations relating to the gasoline and diesel fuel excise tax definitions. The regulations implement certain changes made by the Omnibus Budget Reconciliation Act of 1993 and the Small Business Job Protection Act of 1996. They affect certain enterers, refiners, retailers, terminal operators, throughputters, wholesale distributors, and users.

DATES: These regulations are effective January 2, 1998. For dates of applicability of these regulations, see §§48.4082–5 (h) and 48.6715–1(a)(3).

FOR FURTHER INFORMATION CONTACT: Frank Boland (202) 622–3130 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Section 4081 imposes a tax on certain removals, entries, and sales of diesel fuel. However, under section 4082, tax is not imposed if, among other conditions, the diesel fuel is indelibly dyed in accordance with Treasury regulations. Section 1801 of the Small Business Job Protection Act of 1996 amends section 4082 to create an exception to the dyeing requirement that effectively applies only to diesel fuel that is removed, entered, or sold in Alaska.

Temporary regulations (T.D. 8693 [1997–1 C.B. 192]) relating to this change were published in the Federal Register on December 17, 1996 (61 F.R. 66215) along with a notice of proposed rulemaking (REG–247678–96 [1997–1 C.B. 787]) cross-referencing the temporary regulations (61 F.R. 66246). The notice of proposed rulemaking also proposed other changes to the gasoline and diesel fuel excise tax regulations that were not contained in the temporary regulations.

A public hearing was neither requested nor held. After consideration of written comments, the proposed regulations are adopted as revised by this Treasury decision. Comments and revisions are discussed below.

Explanation of Provisions

The proposed regulations provide a definition of kerosene for purposes of the diesel fuel tax. Several commentators questioned this proposal. Because the IRS is continuing its review of this issue, the final regulations do not define kerosene. However, a definition may be included in a future Treasury decision.

The proposed regulations also include changes to the effective date of other proposed regulations that were published in the **Federal Register** on March 14, 1996 (61 F.R. 10490). Those regulations propose requirements relating to dye injection equipment and are not being finalized at this time. However, the IRS appreciates the concern expressed by several commentators that, as revised, the proposed effective dates still would not give taxpayers sufficient time to comply with the proposed requirements. Thus, the final dye injection regulations will provide a longer period of time between the publication date and the effective date than was proposed.

In response to comments, these final regulations modify the definition of terminal to exclude an otherwise qualifying facility that stores only taxed gasoline and taxed, undyed diesel fuel. As a result of this modification, tax will not be imposed again when the fuel is removed from this type of facility.

The final regulations generally adopt as proposed the provisions dealing with diesel fuel that is removed, entered, or sold in Alaska. However, several comments suggested that the definition of qualified dealer in the proposed regulations was too narrow and prevented unlicensed vendors from selling diesel fuel for exempt uses. In response, the final regulations expand the definition of qualified dealer to include unlicensed diesel fuel retailers that are registered by the IRS under specified conditions. As a result of this modification, many retailers that serve remote communities in Alaska will be able to buy diesel fuel tax free for resale for nontaxable uses.

The final regulations also make minor modifications to existing gasoline and diesel fuel regulations. For example, existing regulations generally require gasoline and diesel fuel refund claims to be filed with the same service center where the claimant's income tax return is filed. Because all excise tax refund claims are now processed at the Cincinnati Service Center, this regulatory provision is removed.

Special Analyses

It has been determined that this Treasury decision is not a significant regula-

tory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these regulations was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

The principal author of these regulations is Frank Boland, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 40 and 48 are amended as follows:

PART 40—EXCISE TAX PROCEDURAL REGULATIONS

Paragraph 1. The authority citation for part 40 continues to read in part as follows:

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

§40.6011(a)–1 [Amended]

Par. 2. Section 40.6011(a)–1(b)(2)(vi) is amended by removing the language "a taxable fuel registrant" and adding "registered under section 4101" in its place.

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Par. 3. The authority citation for part 48 is amended by removing the entry for §48.4082–5T and adding an entry in numerical order to read in part as follows:

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

Section 48.4082–5 also issued under 26 U.S.C. 4082. * * *

Par. 4. Section 48.4081–1 is amended as follows:

1. Paragraph (b) is amended by:

a. Adding a definition in alphabetical order; and

b. Revising the definition of terminal.

2. Paragraph (c)(1)(i) is amended by removing the language "any mixture" and adding "any taxable fuel" in its place and by removing the language "and that consists of" and adding "by mixing" in its place.

3. Paragraph (d) is revised.

The addition and revisions read as follows:

§48.4081–1 Taxable fuel; definitions.

* * * * *

(b) * * *

Aviation gasoline means all special grades of gasoline that are suitable for use in aviation reciprocating engines, as described in ASTM Specification D 910 and Military Specification MIL–G–5572. The ASTM specification may be obtained from the American Society for Testing and Materials and the military specification from the Standardization Document Order Desk at the addresses provided in paragraph (c)(2)(i) of this section.

* * * * *

Terminal means a taxable fuel storage and distribution facility that is supplied by pipeline or vessel and from which taxable fuel may be removed at a rack. However, the term does not include any facility at which gasoline blendstocks are used in the manufacture of products other than finished gasoline and from which no gasoline is removed. Also, effective January 2, 1998, the term does not include any facility operated by a taxable fuel registrant if all of the finished gasoline and diesel fuel (other than diesel fuel dyed in accordance with §48.4082–1(b)) stored at the facility has been previously taxed under section 4081 upon removal from a refinery or terminal.

* * * * *

(d) *Effective date.* This section is applicable January 1, 1994, except that in paragraph (b) of this section the definition of aviation gasoline and the third sentence in the definition of terminal are effective January 2, 1998.

§48.4082–5T [Redesignated as §48.4082–5]

Par. 5. Section 48.4082–5T is redesignated as §48.4082–5 and the language "(temporary)" is removed from the section heading.

Par. 6. Section 48.4082–5, as redesignated, is amended as follows:

1. Paragraph (b) is amended by revising the definition of qualified dealer.

2. Paragraphs (f) and (g) are redesignated as paragraphs (g) and (h), respectively.

3. A new paragraph (f) is added.

4. Paragraph (h), as redesignated, is revised.

The addition and revisions read as follows:

§48.4082–5 Diesel fuel; Alaska

* * * * *

(b) * * *

Qualified dealer means any person that holds a qualified dealer license from the state of Alaska or has been registered by the district director as a qualified retailer. The district director will register a person as a qualified retailer only if the district director—

(1) Determines that the person, in the course of its trade or business, regularly sells diesel fuel for use by its buyer in a nontaxable use; and

(2) Is satisfied with the filing, deposit, payment, and claim history for all federal taxes of the person and any related person.

* * * * *

(f) *Registration.* With respect to each person that has been registered as a qualified retailer by the district director, the rules of §48.4101–1(g), (h), and (i) apply.

* * * * *

(h) *Effective date.* This section is applicable with respect to diesel fuel removed or entered after December 31, 1996. A person registered by the district director as a qualified retailer before April 2, 1998, may be treated, to the extent the district director determines appropriate, as a qualified dealer for the period before that date.

§48.6416(b)(4)–1 [Removed]

Par. 7. Section 48.6416(b)(4)–1 is removed.

§48.6421–3 [Amended]

Par. 8. In §48.6421–3, paragraph (d)(2) is amended by removing the last sentence.

§48.6427–3 [Amended]

Par. 9. In §48.6427–3, paragraph (d)(2) is amended by removing the last sentence.

Par. 10. In §48.6715–1, paragraph (a)(3) is revised to read as follows:

§48.6715–1 Penalty for misuse of dyed diesel fuel.

(a) * * *

(3) The alteration or attempted alteration occurs in an exempt area of Alaska after September 30, 1996.

* * * * *

§48.6715–2T [Removed]

Par. 11. Section 48.6715–2T is removed.

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

Approved November 6, 1997.

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

(Filed by the Office of the Federal Register on December 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1998, 63 F.R. 24)

Order of Applying Federal Tax Deposits

Notice 98–14

PURPOSE

This notice provides an interim procedure that taxpayers may use to request abatement of the failure-to-deposit penalty imposed by § 6656 of the Internal Revenue Code when the manner in which the Internal Revenue Service applies deposits, as set forth in Rev. Proc. 90–58, 1990–2 C.B. 642, produces multiple failure-to-deposit penalties as a result of a single failure to deposit.

BACKGROUND

Section 6656 provides that in the case of any failure by any person to deposit (as required by the Code or regulations) on the date prescribed therefor any amount of tax in a government depository, unless it is shown that such failure is due to reasonable cause and not due to willful neglect, there shall be imposed upon such person a penalty equal to the applicable percentage of the amount of the underpayment. The penalty ranges from 2 to 15 percent depending upon the lateness of the deposit.

Rev. Proc. 90–58, effective for deposit liability periods beginning after March 31, 1991, provides that deposits will be applied in date-made order against deposit liabilities in due-date order. Thus, a deposit will be applied first to satisfy the oldest past due underdeposits within the same return period. Other credits to the taxpayer's account, such as an overpayment from the previous return period, will be similarly applied.

Rev. Proc. 90–58 was issued as a result of changes made to the failure-to-deposit penalty under § 6656 by the Revenue Reconciliation Act of 1989, Pub. L. No. 101–239, 1990–1 C.B. 210, under which the penalty changed from a flat-rate 10 percent penalty to a time-sensitive penalty.

The rationale underlying Rev. Proc. 90–58 is that it is generally in the best interests of depositors that strive to be compliant to have the oldest deposit liability in the return period satisfied first, thus preventing the penalty rate on that underdeposit from escalating. However, if a depositor inadvertently misses a deposit early in a return period but makes all succeeding deposits on a timely basis, the result can be multiple failure-to-deposit penalties.

INTERIM RELIEF PROCEDURE

Any taxpayer that receives multiple failure-to-deposit penalty notices as a result of a single failure to deposit, may call the toll-free number shown on the penalty notice. The Service will, if it deems appropriate, reduce the multiple penalty to the penalty amount due on the missed deposit with respect to return periods beginning after December 31, 1997.

COMMENTS INVITED

The Service intends to provide more specific published guidance on this matter, and requests comments on the methodology this guidance should set forth. Comments should be submitted by April 30, 1998 to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, Attn: CC:DOM:CORP:R (IT&A Branch 4), Room 5226. Submissions may be hand-delivered between the hours of 8 a.m. and 5 p.m. to: Courier's Desk, Internal Revenue Service, 1111 Constitution Ave, NW, Washington, DC, Attn: CC:DOM:CORP:R (IT&A Branch 4), Room 5226. Alternatively, taxpayers may submit comments electronically at

http://www.irs.ustreas.gov/prod/tax_regs/comments.html

(the Service's internet site). All comments submitted will be available for public inspection and copying.

DRAFTING INFORMATION

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

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 98–21

SECTION 1. PURPOSE

This revenue procedure sets forth the procedures concerning requests to the U.S. competent authority for assistance in resolving cases under Article XIII(8) of the Convention Between the United States of America and Canada with respect to Taxes on Income and Capital, dated September 26, 1980, as amended by the Protocols dated June 14, 1983, March 28, 1984, March 17, 1995, and July 29, 1997 ("the Treaty"), 1986–2 C.B. 258. Article XIII(8) of the Treaty permits taxpayers to request the competent authority to defer the recognition of profit, gain, or income with respect to property alienated in the course of a corporate or other organization, reorganization, or similar transaction. See also Rev. Proc. 96–13, 1996–1 C.B. 616, for an updated discussion of the general procedures concerning requests by taxpayers for assistance of the U.S. competent authority under the provisions of an income, estate, or gift tax treaty to which the United States is a party.

SEC. 2. SCOPE

.01 *General.* The U.S. competent authority assists taxpayers concerning matters covered in the mutual agreement provisions of tax treaties in the manner specified in those provisions. A tax treaty generally permits taxpayers to request competent authority assistance when they consider that the actions of the United States, a treaty partner, or both, result, or will result, in taxation that is contrary to the provisions of the treaty. Competent authority matters are a government-to-government activity that does not include the taxpayer's participation.

.02 *Requests for Assistance.* In general, all requests for competent authority assistance must be in accordance with Rev. Proc. 96–13. However, to the extent that this revenue procedure provides additional or inconsistent procedures from those set forth in Rev. Proc. 96–13, the

procedures set forth in this revenue procedure must be followed when requesting competent authority assistance under Article XIII(8) of the Treaty.

.03 *U.S. Competent Authority*. The Assistant Commissioner (International) acts as the U.S. competent authority in administering the operative provisions of tax treaties (including Article XIII(8) of the Treaty) and in interpreting and applying these treaties. In interpreting or applying these tax treaties, the Assistant Commissioner (International) acts only with the concurrence of the Associate Chief Counsel (International). See Delegation Order No. 114 (Rev. 10), Effective date: June 2, 1994.

SEC. 3. BACKGROUND

.01 *General.* Article XIII(8) of the Treaty, as revised by the Protocol of March 17, 1995, provides that:

"Where a resident of a Contracting State alienates property in the course of a corporate or other organization, reorganization, amalgamation, division or similar transaction and profit, gain, or income with respect to such alienation is not recognized for the purpose of taxation in that State, if requested to do so by the person who acquires the property, the competent authority of the other Contracting State may agree, in order to avoid double taxation and subject to terms and conditions satisfactory to such competent authority, to defer the recognition of the profit, gain, or income with respect to such property for the purpose of taxation in that other State until such time and in such manner as may be stipulated in the agreement."

.02 *Purpose of this Provision.* The purpose of Article XIII(8) of the Treaty is to coordinate the U.S. and Canadian nonrecognition rules concerning corporate and other organizations, reorganizations, amalgamations, divisions, and similar transactions in order to avoid double taxation of gain from the alienation of property in the United States and Canada.

SEC. 4. GENERAL CONDITIONS UNDER WHICH THIS PROCEDURE APPLIES

.01 *General.* The assistance of the competent authority is entirely discretionary.

.02 *Types of Assistance*. In connection with Article XIII(8) of the Treaty, the U.S. competent authority handles two types of requests for relief:

(a) requests by Canadian transferees of property for relief from U.S. taxation, and

(b) requests by Revenue Canada for verification of the U.S. tax treatment of transactions of U.S. transferees of property.

.03 *Transactions Subject to U.S. Taxation but not Subject to Canadian Taxation.* Where a transaction is subject to taxation within the United States but qualifies for nonrecognition treatment in Canada, the transferee may request that the U.S. competent authority defer taxation until the time that Canada would impose taxation. In these cases, the U.S. competent authority will contact the Canadian competent authority for verification of the nonrecognition treatment under Canadian law. If nonrecognition treatment in Canada is verified, the U.S. competent authority will consider the facts and circumstances supporting the request in deciding whether to defer the recognition of profit, gain, or income under Article XIII(8) of the Treaty. The taxpayer(s) may be required to enter into a closing agreement in order to obtain the relief. See section 5 of this revenue procedure for guidance in requesting relief from U.S. taxation.

.04 *Transaction Subject to Canadian Taxation but not Subject to U.S. Taxation.* Where Canada would impose tax on a transaction receiving nonrecognition treatment in the United States, the U.S. competent authority will provide verification of nonrecognition treatment by the United States when requested to do so by the Canadian competent authority. To facilitate this process, the taxpayer may wish to request a private letter ruling from the Office of Chief Counsel to substantiate the claim of nonrecognition treatment. Even if the taxpayer does not do so, the U.S. competent authority may require that the taxpayer obtain such a private letter ruling. See section 7 of this revenue procedure for guidance in requesting assistance from the Canadian competent authority under Article XIII(8) of the Treaty.

SEC. 5. PROCEDURES TO BE FOLLOWED FOR RELIEF REQUESTS TO THE UNITED STATES COMPETENT AUTHORITY

.01 *General.* A transferee requesting U.S. competent authority assistance under Article XIII(8) of the Treaty should follow the procedures in Rev. Proc. 96–13.

.02 *Information Required.* The request for assistance must contain a statement that U.S. competent authority assistance is being requested. In addition, it must provide the following information:

(a) a statement that the request is made pursuant to Article XIII(8) of the Treaty and a demonstration that relief is necessary to avoid double taxation;

(b) a statement that the taxpayer seeking benefits from the United States under the Treaty is a "qualified person" within the meaning of Article XXIX A of the Treaty;

(c) the names, addresses, U.S. taxpayer identification number and foreign taxpayer identification number, if any, of the taxpayer and, if applicable, all related persons involved in the matter;

(d) the taxable year(s) at issue;

(e) the Internal Revenue Service Center where the taxpayer (and, if applicable, the related person or persons) filed federal income tax returns (including amended returns) for the taxable years in issue, or if no return was filed, a statement to that effect;

(f) a statement whether the federal income tax returns of the taxpayer (and, if applicable, of any related person or persons) for the taxable years in issue were examined or are under examination;

(g) a full description of the type and amount of income (in both U.S. and Canadian dollars) or property involved; a full description of the relevant transaction and any related transactions, whether the transactions have already been consummated or, if proposed, when they are likely to be effected; a full description of the respective positions taken or proposed by Canada, the taxpayers, and any relevant related person on the issues raised; and, if applicable, a description of the control and business relationships between the taxpayer and any relevant related person for the years in issue, including any changes in such relationship to the date of the request or any changes thereafter;

(h) an explanation of the treatment for U.S. tax purposes in the absence of relief under the Treaty together with a statement of legal authorities;

(i) an explanation of the treatment of the transaction for Canadian tax purposes.

If the taxpayer is relying on a prior ruling given by the Canadian taxing authorities, the taxpayer should attach a copy of that ruling and either provide a statement to the effect that the facts upon which the ruling was based have not changed, or explain exactly how the facts underlying the ruling have changed. The taxpayer should also identify any subsequent change in the law, statute, or regulations upon which the ruling is based;

(j) a statement whether there has been a prior request made to the U.S. competent authority by the taxpayer or a predecessor in interest on the same or related issue, including copies of pertinent correspondence, and a statement of actions requested of, proposed by, or taken by the Assistant Commissioner (International); and

(k) U.S. powers of attorney with respect to the taxpayers.

.03 *Penalties of Perjury Statement.* In addition, the taxpayer must provide a penalties of perjury statement in the following form: "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and, to the best of my knowledge and belief, the facts presented in support of the request for competent authority assistance are true, correct, and complete." This declaration must be signed by the person or persons making the request and not by such person's or persons' representative. The person signing for a corporate taxpayer must be an authorized officer of the taxpayer who has personal knowledge of the facts. The person signing for a trust, an estate, or a partnership must be, respectively, a trustee, an executor, or a partner who has personal knowledge of the facts.

.04 *No deletion statement required.* No deletions statement under section 6110 of the Code is necessary.

.05 *Updates.* It shall be the responsibility of the taxpayer to keep the U.S. competent authority informed of all material changes in the information or documentation previously submitted as part of, or in connection with, the request for competent authority assistance, as well as any new information (including English translations where necessary) or documentation relevant to the resolution of the issues under consideration as it becomes known or available.

SEC. 6. ACTION BY THE U.S. COMPETENT AUTHORITY

.01 *Notification of Taxpayer.* Upon receiving a request for relief pursuant to this revenue procedure, the U.S. competent authority will consider whether the facts provide a basis for assistance.

.02 *Extending Period of Limitations for Assessment.* If the U.S. competent authority accepts a request for assistance, the taxpayer may be requested to execute a consent extending the period of limitations for assessment of tax for the taxable periods in issue. Failure to comply with the provisions of this subsection can result in denial of assistance by the U.S. competent authority with respect to the request.

.03 *Determination regarding relief.* The decision whether to grant relief will be made based upon all of the facts and circumstances.

.04 *No Review of Denial of Request for Assistance.* The U.S. competent authority's denial of a taxpayer's request for assistance or dismissal of a matter previously accepted for consideration pursuant to this revenue procedure is final and not subject to administrative review.

SEC. 7. PROCEDURES TO BE FOLLOWED FOR REQUESTS FOR RELIEF TO THE CANADIAN COMPETENT AUTHORITY

This revenue procedure is intended to coordinate requests for competent authority assistance made to the United States and Canada under Article XIII(8) of the Treaty. Taxpayers who wish to request relief under Article XIII(8) of the Treaty from the Canadian competent authority should follow the procedures outlined in Revenue Canada Information Circular 71–17R4. Information regarding such requests may be obtained from: Revenue Canada, Director General, International Tax Programs Directorate, Ottawa ON K1A 0L8.

SEC. 8. FEES

No user fees are required for a request for competent authority assistance pursuant to this revenue procedure. Section 15 of Rev. Proc. 97–1, 1997–1 I.R.B. 11, at page 46, requires the payment of user fees for requests to the Service for rulings, opinion letters, determination letters, and similar requests.

SEC. 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 96–13 is amplified.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective for requests for U.S. competent authority assistance pursuant to Article XIII(8) of the Treaty that are filed after February 23, 1998.

DRAFTING INFORMATION

The principal author of this revenue procedure is David Bergkuist of the Office of Associate Chief Counsel (International). For further information regarding this revenue procedure, contact the Office of the Assistant Commissioner (International), Tax Treaty Division, on (202) 874-1550 (not a toll-free call).

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Agreements for Payment of Tax Liability in Installments

REG–100841–97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to terminations of agreements for the payment of tax liabilities in installments (installment agreements). The proposed regulations reflect changes made to section 6159 of the Internal Revenue Code of 1986 (Code) by the Taxpayer Bill of Rights 2. The proposed regulations provide a procedure for requesting an independent administrative review of an alteration, modification, or termination of an installment agreement.

DATES: Written comments and requests for a public hearing must be received by March 31, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–100841–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m.: CC:DOM:CORP:R (REG–100841–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Kevin B. Connelly, (202) 622-3640 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Procedure and Administration Regulations (26 CFR part 301) relating to installment agreements under section 6159 of the Code. Section 201 of the Taxpayer Bill of Rights 2 (TBOR2), Pub. L. No. 104–168, 110 Stat. 1452 (1996), amended section 6159 to provide that the Secretary may not alter, modify, or terminate an installment agreement unless notice of such action is given not later than 30 days before the date of the action. The notice must explain why the Secretary intends to take the proposed action. Section 202 of TBOR2 provides that the Secretary shall provide an independent administrative review of the termination of an installment agreement upon request of the taxpayer. These proposed regulations reflect the change made by Section 202 of TBOR2. In addition, although the IRS rarely alters or modifies an installment agreement, the proposed regulations give taxpayers the right to an independent administrative review of alterations or modifications.

Explanation of Provisions

Sections 201 and 202 of TBOR2 amended section 6159 of the Code with respect to installment agreements. Section 201 provides that the Secretary may not alter, modify, or terminate an installment agreement unless notice of such action is given to the taxpayer at least 30 days before the action. The notice must explain why the Secretary intends to take the proposed action. Notice is not necessary if collection of the tax to which the installment agreement relates is in jeopardy.

Prior to the enactment of TBOR2, Section 6159 of the Code required notice only if the Internal Revenue Service intended to alter, modify, or terminate an installment agreement because of a change in the taxpayer's financial condition. Section 301.6159–1(c)(4) of the regulations that are being amended by this notice of proposed rulemaking, however, already requires 30 days notice whenever the IRS intends to alter, modify, or terminate any agreement, regardless of the reason for the action. The only exception to this rule is that no notice is required if collection of the tax to which the installment agreement relates is in jeopardy. In addition, existing paragraph (c)(4) requires the notice to explain the reason for the intended action. In light of existing paragraph (c)(4), the regulations do not have to be amended to reflect section 201 of TBOR2.

Section 202 of TBOR2 provides that, upon request by a taxpayer, the Secretary shall provide an independent administrative review of the termination of an installment agreement. In addition, although the IRS rarely alters or modifies an installment agreement, the proposed regulations grant taxpayers the right to request an independent administrative review of alterations or modifications. Procedures for requesting an independent administrative review are contained in the proposed regulations.

When the Internal Revenue Service intends to terminate an installment agreement, it currently sends the taxpayer a written notice of its intent. The notice (1) informs the taxpayer why the Internal Revenue Service intends to terminate the agreement, (2) notifies the taxpayer that the Internal Revenue Service intends to levy the taxpayer's property, (3) explains that the taxpayer has a right to request an independent review of the Internal Revenue Service's decision, and (4) tells the taxpayer to call the telephone number listed on the notice within 30 days of the date of the notice if the taxpayer wishes to stay collection and request the Internal Revenue Service to review its decision. If the taxpayer timely calls the telephone number listed on the notice, the employee attempts to resolve the case with the taxpayer. If the taxpayer and the employee are not able to resolve the case to the taxpayer's satisfaction, a conference is set up with a manager. If the manager and the taxpayer are unable to resolve the case, the manager forwards the case to Appeals for an independent administrative review. Absent jeopardy, collection action is stayed until the appeals officer has informed the taxpayer of a decision.

The proposed regulations provide that, if a taxpayer disagrees with a determination to alter, modify, or terminate an installment agreement, the taxpayer may initiate an independent administrative review of the determination by calling the telephone number listed on the notice within

30 days of the date of the notice. This will set the review process in motion.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of these regulations is Kevin B. Connelly, Office of Assistant Chief Counsel (General Litigation) CC:EL:GL, IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 301 is proposed to be amended as follows:

PART 301—PROCEDURE AND ADMINISTRATION

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

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

Par. 2. Section 301.6159–1 is amended by revising paragraphs (c)(4) and (g) to read as follows:

§301.6159–1 Agreements for payment of tax liability in installments.

* * * * *

(c) * * *

(4) *Notice.* Unless the director determines that collection of the tax is in jeopardy, the director will notify the taxpayer in writing at least 30 days before altering, modifying, or terminating an installment agreement pursuant to paragraph (c)(1) or (2) of this section. A notice provided pursuant to this paragraph must briefly describe the reason for the intended alteration, modification, or termination. If the taxpayer disagrees with the director's decision to terminate, alter, or modify the installment agreement, the taxpayer has the right to an independent administrative review. The taxpayer may initiate an independent administrative review by calling the telephone number listed on the notice within 30 days of the date of the notice. If, upon calling the telephone number listed on the notice, the dispute is not resolved to the taxpayer's satisfaction, the taxpayer must speak with a manager. If, after speaking with a manager, the dispute still is not resolved to the taxpayer's satisfaction, the taxpayer may request the Office of Appeals to independently review the decision. The Office of Appeals shall conduct a review to determine whether the facts and circumstances warrant the alteration, modification, or termination of the taxpayer's installment agreement.

* * * * *

(g) *Effective date.* This section is applicable December 23, 1994, except that paragraph (c)(4) of this section is applicable on the date final regulations are published in the Federal Register.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 30, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 31, 1997, 62 F.R. 68241)

Notice of Proposed Rulemaking and Notice of Public Hearing

Certain Investment Income

REG–105163–97

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations relating to the treatment of certain investment income under the qualifying income provisions of section 7704(d) and the application of the passive activity loss rules to publicly traded partnerships. The regulations would affect the classification of certain partnerships for federal tax purposes and would also affect the passive activity loss limitations with respect to items attributable to publicly traded partnerships. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written comments must be received by March 19, 1998. Requests to speak (with outlines of oral comments) at a public hearing scheduled for April 28, 1998, at 10 a.m., must be received by April 7, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-105163-97), room 5228, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–105163–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in Room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Christopher Kelley, (202) 622-3080; concerning submissions and the hearing,

Evangelista Lee, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Introduction

This document proposes to add §1.7704–3 to the Income Tax Regulations (26 CFR part 1) relating to the definition of qualifying income for publicly traded partnerships under section 7704(d) of the Internal Revenue Code (Code). This document also proposes to amend §1.469–10 of the Income Tax Regulations relating to the application of section 469 of the Code to publicly traded partnerships.

Explanation of Provisions

Qualifying Income

Section 7704 of the Code provides that a publicly traded partnership is generally treated as a corporation for federal tax purposes unless 90 percent or more of the gross income of the partnership consists of qualifying income. Section 7704(d) defines qualifying income to include certain types of passive investment income, such as interest, dividends, real property rents, and income that would qualify under the regulated investment company provisions in section 851(b)(2) or the real estate investment trust provisions in section 856(c)(2). Since section 7704 was enacted, however, several new types of financial instruments have been developed that generate passive-type investment income similar to interest and dividends. The preamble to the regulations under §1.7704–1, issued December 4, 1995, (regarding the definition of public trading) requested comments from the public on the definition of qualifying income for investment partnerships and other partnerships engaged in various types of securities transactions.

In response to comments received, the proposed regulations provide that qualifying income for purposes of section 7704(c) includes income from holding annuities, income from notional principal contracts (as defined in §1.446–3), and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. Qualifying income, however, includes income from a notional principal contract only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership. The proposed regulations also confirm that capital gain from the sale of stock is qualifying income, regardless of whether the stock pays dividends. The proposed regulations also provide that qualifying income (as defined in the proposed regulations) does not include income derived in the ordinary course of a trade or business by a broker, dealer, or market maker. Income derived by traders and investors can be qualifying income under the proposed regulations. The proposed regulations, including the trade or business restriction, are consistent with the legislative history of section 7704, which indicates that the exception for passive investment income was intended to distinguish between partnerships engaged in investment activities and those partnerships engaged in active business activities that are more typically conducted in corporate form. See H.R. Rep. No. 391 (Part 2), 100th Cong., 1st Sess. 1066–69 (House Report). The IRS also requests comments on the appropriate way to determine how gains should be measured for purposes of determining whether 90 percent or more of the partnership's gross income is qualifying income when a partnership makes a mixed straddle account election under §1.1092(b)–4T. The IRS believes that use of the daily mark-to-market method provided for by §1.1092(b)–4T would be inconsistent with the congressional purpose behind section 7704.

Passive Activity Loss Rules

Section 469(a) generally provides that if for any taxable year the taxpayer is an individual, estate, trust, closely held C corporation, or personal service corporation, neither the passive activity loss nor the passive activity credit for the taxable year is allowed. Section 469(k) provides that section 469 applies separately with respect to items attributable to each publicly traded partnership. Section 469(k)(2) defines a publicly traded partnership in the same manner as section 7704(b). The legislative history of section 469(k) indicates that the term publicly traded partnership has the same meaning for purposes of section 469(k) as it does for purposes of section 7704. See H.R. Rep. No. 495, 100th Cong., 1st Sess. 952–53 (1987) (Conference Report). In addition, Notice 88–75 (1988–2 C.B. 386) provided the same guidance on the definition of a publicly traded partnership for purposes of both sections 469(k) and 7704.

The recently issued regulations under §1.7704–1, however, define a publicly traded partnership only for purposes of section 7704. The proposed regulations implement the legislative history of section 469(k) by providing that the definition of a publicly traded partnership for purposes of section 469(k) is the same as the definition of publicly traded partnership under section 7704.

Proposed Effective Date

These regulations are proposed to apply for taxable years of a partnership beginning on or after the date the final regulations are published in the **Federal Register.**

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulations do not impose a collection of information on small entities, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

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

A public hearing has been scheduled for Tuesday, April 28, 1998, at 10 a.m., in Room 2615, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions,

visitors will not be admitted beyond the Internal Revenue Building lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit timely written comments (preferably a signed original and eight (8) copies) by March 19, 1998 and submit an outline of the topics to be discussed and the time to be devoted to each topic by April 7, 1998.

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

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

Drafting Information

The principal author of these regulations is Christopher Kelley, Office of Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.469-10 is revised to read as follows:

§1.469–10 Application of section 469 to publicly traded partnerships.

(a) [Reserved].

(b) *Publicly traded partnership*—(1) *In general.* For purposes of section 469(k), a partnership is a publicly traded partnership only if the partnership is a publicly traded partnership as defined in §1.7704–1.

(2) *Effective date.* This section applies for taxable years of a partnership beginning on or after the date final regulations are published in the **Federal Register.**

Par. 3. Section 1.7704-3 is added to read as follows:

§1.7704–3 Qualifying income.

(a) *Certain investment income*—(1) *In general.* For purposes of section 7704(d)(1), qualifying income includes capital gain from the sale of stock, income from holding annuities, income from notional principal contracts (as defined in §1.446–3), and other substantially similar income from ordinary and routine investments to the extent determined by the Commissioner. Income from a notional principal contract is included in qualifying income only if the property, income, or cash flow that measures the amounts to which the partnership is entitled under the contract would give rise to qualifying income if held or received directly by the partnership.

(2) *Limitations.* Qualifying income as defined in paragraph (a)(1) of this section does not include income derived in the ordinary course of a trade or business. For purposes of the preceding sentence, income derived from an asset with respect to which the partnership is a broker, market maker, or dealer is treated as income derived in the ordinary course of a trade or business; income derived from an asset with respect to which the taxpayer is a trader or investor is not treated as income derived in the ordinary course of a trade or business.

(b) *Effective date.* This section applies for taxable years of a partnership beginning on or after the date final regulations are published in the **Federal Register.**

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 18, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 19, 1997, 62 F.R. 66575)

Notice of Proposed Rulemaking and Notice of Public Hearing

General Rules for Making and Maintaining Qualified Electing Fund Elections

REG–115795–97

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Notice of proposed rulemaking by cross-reference to temporary regulations and notice of public hearing.

SUMMARY: In *** T.D. 8750, page 4 of this Bulletin, the IRS is issuing temporary regulations that provide guidance to a passive foreign investment company (PFIC) shareholder that makes the election under section 1295 (section 1295 election) to treat the PFIC as a qualified electing fund (QEF). The temporary regulations also provide guidance for shareholders that wish to make a section 1295 election that will apply on a retroactive basis (retroactive election). The temporary regulations also include a rule concerning the taxation under section 1291 of an exempt organization that is a shareholder of a PFIC that is not a pedigreed QEF. This rule was originally proposed in 1992. The text of the temporary regulations also serves as the text of these proposed regulations. In addition, this document proposes amendments to proposed regulation § 1.1296–4(e), concerning the treatment of interbank deposits as loans for purposes of the exception to passive income characterization of income derived in the active conduct of a banking business. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written comments must be received by April 2, 1998. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for April 16, 1998, must be received by March 26, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–115795–97), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–115795–97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html. The public hearing will be held in Room 3313, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Gayle Novig, (202) 622-3840; concerning sub-

missions and the hearing, Evangelista Lee, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

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

Comments on the collection of information should be sent to the **Office of Management and Budget,** Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service,** Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information should be received by March 3, 1998. Comments are specifically requested concerning:

Whether the proposed collection of information is necessary for the proper performance of the functions of the Internal Revenue Service, including whether the information will have practical utility;

The accuracy of the estimated burden associated with the proposed collection of information (see below);

How the quality, utility, and clarity of the information to be collected may be enhanced;

How the burden of complying with the proposed collection of information may be minimized, including through the application of automated collection techniques or other forms of information technology; and

Estimates of capital or start-up costs and costs of operation, maintenance, and purchase of services to provide information.

The collection of information in this proposed regulation is in proposed regulation §§ 1.1295–1(f), 1.1295–1(g), 1.1295–3(c), and 1.1295–3(g). The information required in § 1.1295–1(f) and (g) will notify the Internal Revenue Service that certain shareholders have made the section 1295 election, and will enable the Internal Revenue Service to determine if a shareholder is satisfying the election and annual reporting requirements and is reporting income as required under section 1293.

The information required in proposed regulation § 1.1295–3(c) will notify the IRS that certain shareholders of foreign corporations have filed a Protective Statement to preserve their ability to make a retroactive section 1295 election, and that those shareholders have extended the periods of limitations for their taxable years to which the Protective Statement will apply. The information will enable the IRS to verify that the shareholders filing the Protective Statement had the requisite reasonable belief at the time they filed the statement. The information required in proposed regulation § 1.1295–3(g) will notify the IRS that a shareholder has made the retroactive election and, in the case of a shareholder that filed a Protective Statement, that the shareholder's waiver of the periods of limitations will terminate within three years of making the election. The information will enable the Service to verify that the requirements for making a retroactive election have been satisfied.

The collection of information and responses to these collections of information are mandatory. The likely respondents are individuals, businesses, and other for-profit organizations.

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 assigned by the Office of Management and Budget.

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

Estimated total annual reporting/recordkeeping burden: 623 hours. The estimated annual burden per respondent varies from 15 minutes to three hours, depending on individual circumstances, with an estimated average of 29 minutes.

Estimated number of respondents: 1,290.

Estimated annual frequency of responses: Annually or one time only.

Background

Sections 1291, 1293, 1295, and 1297.

Temporary regulations in T.D. 8750 amend the Income Tax Regulations (26 CFR part 1) relating to sections 1291, 1293, 1295, and 1297. The temporary regulations contain rules concerning the taxation of exempt organizations under section 1291, elections under section 1295 to treat passive foreign investment companies as qualified electing funds (QEFs), the calculation of net capital gain for purposes of section 1293, and the inclusion of the pro rata shares of the earnings and profits of QEFs held through pass through entities. The temporary regulations amend § 1.1297–3T, permitting in certain cases the application of the rules of section 1291(d)(2)(B) to an election made under section 1297(b)(1).

The text of those temporary regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the temporary regulations.

Section 1296.

On April 28, 1995, proposed regulations were published providing guidance for the exceptions to passive income characterization of certain income derived by active foreign banks and foreign security dealers provided in section 1296(b)(2)(A) and (b)(3), respectively. The proposed section 1296 regulations reflect comments received with respect to Notice 89–81, 1989–2 C.B. 399. That notice established tests for determining whether a foreign corporation qualified for the active foreign bank exception. The notice specifically stated that interbank deposits would not be treated as loans made in the ordinary course of a banking business.

After consideration of the comments received with respect to the Notice, the IRS and Treasury determined that interbank deposits were made and accepted in the ordinary course of a banking business, and therefore should be treated as such for purposes of section 1296(b)(2)(A). Accordingly, proposed regulation § 1.1296–4(d)(3) specifically includes interbank deposits with other deposits for purposes of determining whether the foreign corporation satisfies the deposit-taking requirements of § 1.1296–4(d). Also in response to comments, proposed regulation § 1.1296–4(e) is clarified to specifically provide that interbank deposits made with banks in the ordinary course of business constitute loans for purposes of § 1.1296–4. This clarification is favorable to taxpay-

ers, and is proposed to be effective for taxable years beginning after December 31, 1994. It is also proposed that taxpayers may apply it to a taxable year beginning after December 31, 1986, provided it is consistently applied to that taxable year and all subsequent taxable years. The dates for applying proposed regulation § 1.1296–4(e) coincide with the dates for which § 1.1296–4 is proposed to be effective. See proposed regulation § 1.1296–4(k).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business. It has been determined that an initial regulatory flexibility analysis is required for the collection of information in this notice of proposed rulemaking under 5 U.S.C. § 603. This analysis is set forth below under the heading 'Initial Regulatory Flexibility Analysis.'

Initial Regulatory Flexibility Analysis. This initial analysis is provided pursuant to the Regulatory Flexibility Act (5 U.S.C. chapter 6). The major objective of the proposed regulations is to provide guidance to PFIC shareholders that wish to elect under section 1295 to treat their PFICs as QEFs, and provide guidance to those PFICs about the requirements imposed on them. The legal basis for these requirements is contained in sections 1293, 1294, and 1295. The IRS and Treasury are not aware of any federal rules that duplicate, overlap, or conflict with the proposed regulations.

The recordkeeping and reporting requirements of the proposed regulations enable the Internal Revenue Service to identify those taxpayers that are treating their PFICs as QEFs; to verify that those U.S. taxpayers are currently including their shares of QEF earnings in income, as required in section 1293 of the Internal Revenue Code; to be informed of those QEF shareholders that are not paying their section 1293 tax liability because they made the section 1294 election to defer the time for payment; to identify those shareholders of foreign corporations that are preserving their right to make a retroactive section 1295 election; to identify those shareholders making retroactive elections and verify that they are satisfying the requirements of a retroactive election; and, in the case of shareholders that have filed Protective Statements, the dates by which the shareholders' extensions of periods of limitations will terminate.

These proposed regulations will affect those small entities that are PFICs, at least one shareholder of which makes the section 1295 election. The proposed regulations also will affect those small entities that are PFIC shareholders that make the section 1295 election. The IRS and Treasury believe that affected small entities generally will be small businesses, as local governments are not likely to invest in PFICs. Also, few, if any, affected small entities likely will be tax exempt organizations, because only a tax exempt entity that is taxable under subchapter F on dividends received from the PFIC generally would need to consider making the section 1295 election.

The collections of information in these proposed regulations would impact a small entity that is treated as a QEF principally by requiring the entity to calculate annually its ordinary earnings and net capital gain according to federal income tax accounting principles, as required by section 1293, and report that information to its shareholders that are U.S. persons. With the enactment of section 1(h), the QEF also must calculate each type of long term capital gain that it derived and the applicable rates of tax for proper inclusion of the QEF's net capital gain by the QEF shareholders. Alternatively, the regulations permit the QEF to provide its shareholders with its books, records and other documents necessary for the shareholders to calculate the ordinary earnings and net capital gain amounts. This alternative will enable a small entity that is a QEF to avoid the burden of calculating its net capital gain by providing its shareholders with information with which the shareholders can make the calculations.

The economic impact of other collections of information contained in these proposed regulations would fall on a small entity that is a shareholder of a PFIC for which it has made the section 1295 election or that is a pass through entity to which an interest holder transferred stock subject to a section 1295 election. The economic impact would result primarily from the reporting and recordkeeping requirements pertaining to (1) the manner for making the section 1295 election and the annual election requirements; (2) the calculation by the shareholder (rather than the QEF) of the QEF's ordinary earnings and net capital gain according to federal income tax principles, and its pro rata shares thereof; (3) a request for consent to revoke a section 1295 election; (4) the preservation of the right to make a retroactive election under section 1295; (5) a request for consent to make a retroactive election; (6) making a retroactive election, including filing amended returns for the affected taxable years; and (7) providing interest holders with PFIC statements and other information received by an intermediary shareholder.

The proposed regulations reduce the burden under existing rules for making the section 1295 election for all taxpayers, including small businesses and other small entities. Unlike the current requirements provided in Notice 88–125, the proposed regulations only require electing shareholders to file Form 8621 to make the section 1295 election, thereby eliminating the shareholder election statement as well as the requirement to file a copy of the PFIC Annual Information Statement. The proposed regulations only require shareholders to retain the PFIC Annual Information Statement or the Annual Intermediary Statement received as well as a copy of their filings for each year to which the section 1295 election applies. In addition, the proposed regulations impose a lesser burden on small shareholders, typically individuals and small entities, to preserve their right to make a retroactive election and a lesser burden of making a retroactive election. A small entity that owns less than five percent of each class of stock of a foreign corporation and satisfies other requirements is not required to file a Protective Statement to preserve its right to make a retroactive election with respect to the foreign corporation. Similarly, a small entity potentially has fewer amended returns to file to make a retroactive election than a shareholder that filed a Protective Statement. These changes in election requirements are illustrative of IRS efforts to

minimize burden, particularly with respect to small entities.

An estimate of the number of small entities that would be affected by these regulations is unavailable. In any event, the enactment in 1997 of the mark-to-market election for PFIC shareholders and the elimination of the overlap in certain cases of subpart F and the PFIC provisions, will reduce the number of small entities that would be affected by these regulations.

None of the significant alternatives considered in drafting these regulations would have significantly altered the economic impact of the collections of information on small entities. In considering the significant alternatives that would be permissible under the Code and would enable the IRS to ensure compliance with the Code, the IRS and Treasury concluded that the alternatives generally would impose equal or greater burdens.

Comments and Public Hearing

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

A public hearing has been scheduled for April 16, 1998, at 10 a.m., in room 2615, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue lobby more than 15 minutes before the hearing starts.

The rules of 26 CFR 601.601(a)(3) apply to the hearing.

Persons that wish to present oral comments at the hearing must submit written comments by April 2, 1998, and submit an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by March 26, 1998.

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

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

Drafting Information

The principal authors of the proposed regulations are Gayle Novig and Judith Cavell Cohen, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

* * * * *

Proposed Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.1291–1 is added to read as follows:

[The text of this proposed section is the same as the text of § 1.1291–1T published in T.D. 8750.]

Par. 3. Section 1.1293–1 is added to read as follows:

§ 1.1293–1 Current taxation of income from qualified electing funds.

[The text of this proposed section is the same as the text of § 1.1293–1T published in T.D. 8750.]

Par. 4. Section 1.1295–1 is added to read as follows:

§ 1.1295–1 Qualified electing funds.

[The text of this proposed section is the same as the text of § 1.1295–1T published in T.D. 8750.]

Par. 5. Section 1.1295–3 is added to read as follows:

§ 1.1295–3 Retroactive elections.

[The text of this proposed section is the same as the text of § 1.1295–3T published in T.D. 8750.]

Par. 6. In § 1.1297–3, paragraph (c) is added to read as follows:

§ 1.1297–3 Deemed sale election by a United States person that is a shareholder of a passive foreign investment company.

[The text of this proposed paragraph (c) is the same as the text of § 1.1297–3T(c) published in T.D. 8750.]

Par. 7. Section 1.1296–4(e), as proposed at 60 F.R. 20922 (April 28, 1995), is amended by adding a sentence at the end of the paragraph to read as follows:

§ 1.1296-4 Characterization of certain banking income of foreign banks as passive.

* * * * *

(e) *Lending activities test.* *** An interbank deposit made in the ordinary course of a corporation's banking business will be treated as a loan for purposes of this section. For the effective date of this paragraph (e), see paragraph (k) of this section.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1998, 63 F.R. 35)

Notice of Proposed Rulemaking

Loans to Plan Participants

REG–209476–82

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document amends proposed Income Tax Regulations under section 72(p) of the Internal Revenue Code relating to loans made from a qualified employer plan to plan participants or beneficiaries. Section 72(p) was added by section 236 of the Tax Equity and Fiscal Responsibility Act of 1982, and amended by the Technical Corrections Act of 1982, the Deficit Reduction Act of 1984, the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. These regulations provide guidance to the public with respect to section 72(p), and affect administrators of, participants in, and beneficiaries of qualified employer plans that permit participants or beneficiaries to receive loans from the plan (including loans from section 403(b) contracts and other contracts issued under qualified employer plans).

DATES: Written comments and requests for a public hearing must be received by April 2, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG–209476–82), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG–209476–82), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Vernon S. Carter, (202) 622-6070; concerning submissions or requests to speak at the hearing, La Nita VanDyke, (202) 622-7190 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Proposed Income Tax Regulations (26 CFR Part 1) under section 72 of the Internal Revenue Code of 1986 (Code). These amendments provide additional guidance concerning the tax treatment of loans that are deemed to be distributed under section 72(p).

Explanation of Provisions

Section 72(p)(1)(A) provides that a loan from a qualified employer plan (including a contract purchased under a qualified employer plan) to a participant or beneficiary is treated as received as a distribution from the plan for purposes of section 72 (a deemed distribution). Section 72(p)(1)(B) provides that an assignment or pledge of (or an agreement to assign or pledge) any portion of a participant's or beneficiary's interest in a qualified employer plan is treated as a loan from the plan.

Section 72(p)(2) provides that section 72(p)(1) does not apply to the extent certain conditions are satisfied. Specifically, under section 72(p)(2), a loan from a qualified employer plan to a participant or beneficiary is not treated as a distribution from the plan if the loan satisfies requirements relating to the term of the loan and the repayment schedule, and to the extent the loan satisfies certain limitations on the amount loaned.

Regulations were proposed in 1995[1] with respect to many of the issues arising under section 72(p)(2). The preamble to the 1995 proposed regulations requested comments on whether further guidance should be provided on certain issues that were not addressed. Following publication of the 1995 proposed regulations, comments were received and a public hearing was held on June 28, 1996. One of the issues on which comments were requested and received was the effect of a deemed distribution on the tax treatment of subsequent distributions from a plan (such as whether a participant has tax basis as a result of a deemed distribution). After reviewing the written comments and comments made at the public hearing, these new proposed regulations address this issue.

These new proposed regulations provide that once a loan is deemed distributed under section 72(p), the interest that accrues thereafter on that loan is not included in income.[2] Further, because the loan amount is treated as distributed for purposes of section 72, neither the income that resulted from the deemed distribution nor the interest that accrues thereafter increases the participant's investment in the contract (tax basis) for purposes of section 72.

For example, assume that, after a loan has been made from a defined contribution plan to a participant, a deemed distribution occurs as a result of failure to make timely loan repayments (e.g., the repayments were not to be made by payroll withholding[3]). The participant's total account then consists of non-loan assets and a receivable for the loan balance. At separation from employment, the participant's vested account balance is reduced (offset) by the loan amount and the remaining account balance is distributed in a lump sum to the participant. In this case, in addition to the income that previously arose as a result of the deemed distribution due to the failure to make timely payments on the loan, the participant would have a taxable distribution at separation from employment for the remaining account balance reflecting the non-loan assets that are distributed in a lump sum (with no tax basis as a result of the prior deemed distribution of the loan amount). The offset of the loan balance (i.e., the offset of the loan receivable by the loan amount) would be disregarded for purposes of section 72 because the loan had previously been deemed distributed as a result of the failure to make timely payments on the loan.

A loan that is deemed distributed under section 72 is nevertheless outstanding for other purposes until the loan obligation is satisfied (e.g., by cash repayment or by offset against the participant's accrued benefit). Q&A–13 of the 1995 proposed regulations lists other differences between a deemed distribution and a loan offset. In addition, for purposes of calculating the maximum permitted amount of any subsequent loan, a loan that has been deemed distributed is considered outstanding until the loan obligation has been satisfied.

The proposed regulations also provide that if a participant makes any cash repayments on a loan after the loan is deemed distributed, the repayments increase the participant's tax basis in the plan in the same manner as if the repayments were

[1]Proposed §1.72(p)–1 (EE–106–82) was published in the Federal Register (60 F.R. 66233) on December 21, 1995.

[2]This treatment applies for purposes of determining the amount taxable under section 72 (including application of return of tax basis). However, as discussed below, the loan is still considered outstanding for purposes of determining the maximum amount of any subsequent loan to the participant under section 72(p)(2)(A). Even though interest continues to accrue on the outstanding loan and is taken into account for purposes of determining the maximum amount of any subsequent loan, this additional interest is not treated as a additional loan that results in a further deemed distribution for purposes of section 72(p).

[3]With respect to coverage under Title I of the Employee Retirement Income Security Act of 1974, the Department of Labor has advised the Service that an employer's tax-sheltered annuity program would not necessarily fail to satisfy the Department's regulation at 29 CFR 2510.3–2(f) merely because the employer permits employees to make repayments of laons made in connection with the tax-sheltered annuity program through payroll deductions as part of the employer's payroll deduction system, if the program operates within the limitations set by that regulation.

after-tax contributions. However, such repayments are not treated as after-tax contributions for purposes of section 401(m) or 415(c)(2)(B).

These regulations are proposed to become effective for loans made on or after the first January 1 that is at least 6 months after the date the regulations are published as final regulations in the Federal Register (the regulatory effective date). These regulations also revise the proposed effective date for the 1995 proposed regulations, so that the same proposed effective date would apply to the 1995 proposed regulations and these proposed regulations.

Generally, a plan is permitted to apply the new proposed regulations to loans made before the regulatory effective date. However, the regulations include a special consistency rule applicable if there has been any deemed distribution of the loan before the date the plan switches to the new proposed regulations for the loan. In this event, a plan is not permitted to apply the new proposed regulations to the loan unless the plan reported, in Box 1 of Form 1099–R, a gross distribution with respect to the loan that is at least equal to the amount required by the 1995 proposed regulations (referred to as the initial default amount in the new proposed regulations) for a taxable year that is not later than the latest year that would be permitted under the 1995 proposed regulations. In such a case, the plan may apply the new proposed regulations to the loan even though, in the past, the plan reported deemed distributions with respect to the loan in a manner that is not consistent with the new proposed regulations.

If a plan does apply the new proposed regulations to a pre-regulatory effective date loan that has been deemed distributed, then the plan, in its subsequent reporting and withholding, must not attribute investment in the contract (tax basis) to the participant based upon the initial default amount. For example, a plan that reported income for the initial default amount plus all interest accruing thereafter as a result of the default and made corresponding increases in the participant's tax basis would comply with this consistency rule by reducing the participant's tax basis by an amount equal to the initial default amount. In addition, a special rule applies if a plan had increased a participant's tax basis by the initial default amount and, just before the first actual distribution made after the plan switches to applying the new proposed regulations to the loan, the sum of the participant's tax basis immediately before the switch plus any increase in basis thereafter (e.g., from after-tax contributions) is less than the initial default amount (as a result of intervening distributions). In this case, a loan transition amount equal to the amount by which the initial default amount exceeds the participant's tax basis is treated as remaining outstanding and that amount is includible in the participant's income at the time of the next actual distribution from the plan to the participant. The proposed regulations include examples illustrating the application of the consistency rule.

Comments are requested on whether the final regulations should include further guidance relating to plan loans made to participants before the regulatory effective date.

Taxpayers may rely on these proposed regulations for guidance pending the issuance of final regulations. If, and to the extent, future guidance is more restrictive than the guidance in these proposed regulations, the future guidance will be applied without retroactive effect.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

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

* * * * *

Amendments to the Previously Proposed Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.72(p)–1 of the proposed regulations published December 21, 1995, (60 FR 66233) is amended as follows:

1. Q&A–19 is redesignated as Q&A–21.

2. New Q&A–19 and Q&A–20 are added.

3. Q&A–21, as redesignated, is revised.

The additions and revision read as follows:

§ 1.72(p)–1 Loans treated as distributions.

* * * * *

Q–19: If there is a deemed distribution under section 72(p), is the interest that accrues thereafter on the amount of the deemed distribution an indirect loan for income tax purposes?

A–19: (a) *General rule.* Except as provided in paragraph (b) of this Q&A–19, a deemed distribution of a loan is

treated as a distribution for purposes of section 72. Therefore, a loan that is deemed to be distributed under section 72(p) ceases to be an outstanding loan for purposes of section 72, and the interest that accrues thereafter under the plan on the amount deemed distributed is disregarded in applying section 72 to the participant or beneficiary. Even though interest continues to accrue on the outstanding loan (and is taken into account for purposes of determining the tax treatment of any subsequent loan in accordance with paragraph (b) of this Q&A–19), this additional interest is not treated as an additional loan (and, thus, does not result in an additional deemed distribution) for purposes of section 72(p). However, a loan that is deemed distributed under section 72(p) is not considered distributed for all purposes of the Internal Revenue Code. See Q&A–11 through Q&A–16 of this section.

(b) *Exception for purposes of applying section 72(p)(2)(A) to a subsequent loan.* A loan that is deemed distributed under section 72(p) (including interest accruing thereafter) and that has not been repaid (such as by a plan loan offset) is considered outstanding for purposes of applying section 72(p)(2)(A) to determine the maximum amount of any subsequent loan to the participant or beneficiary.

Q–20: Is a participant's tax basis in the plan increased if the participant repays the loan after a deemed distribution?

A–20: (a) *Repayments after deemed distribution*. Yes, if the participant or beneficiary repays the loan after a deemed distribution of the loan under section 72(p), then, for purposes of section 72(e), the participant's or beneficiary's investment in the contract (tax basis) under the plan increases by the amount of the cash repayments that the participant or beneficiary makes on the loan after the deemed distribution. However, loan repayments are not treated as after-tax contributions for other purposes, including sections 401(m) and 415(c)(2)(B).

(b) *Example.* The following example illustrates the rules in paragraph (a) of this Q&A-20 and is based on the assumptions described in ASSUMPTIONS FOR EXAMPLES:

Example. (a) A participant receives a $20,000 loan on January 1, 1999, to be repaid in 20 quarterly installments of $1,245 each. On December 31, 1999, the outstanding loan balance ($19,179) is deemed distributed as a result of a failure to make quarterly installment payments that were due on September 30, 1999 and December 31, 1999. On June 30, 2000, the participant repays $5,147 (which is the sum of the three installment payments that were due on September 30, 1999, December 31, 1999, and March 31, 2000, with interest thereon to June 30, 2000, plus the installment payment that was due on June 30, 2000). Thereafter, the participant resumes making the installment payments of $1,245 from September 30, 2000 through December 31, 2003. The loan repayments made after December 31, 1999 through December 31, 2003 total $22,577.

(b) Because the participant repaid $22,577 after the deemed distribution that occurred on December 31, 1999, the participant has investment in the contract (tax basis) equal to $22,577 as of December 31, 2003.

Q–21: When is the effective date of section 72(p) and these regulations?

A–21: (a) *Statutory effective date.* Section 72(p) generally applies to assignments, pledges, and loans made after August 13, 1982.

(b) *Regulatory effective date.* This section applies to assignments, pledges, and loans made on or after the first January 1 that is at least 6 months after the date of publication of the final regulations in the Federal Register (the regulatory effective date).

(c) *Loans made before the regulatory effective date* — (1) *General rule.* A plan is permitted to apply Q&A–19 and Q&A–20 of this section to a loan made before the regulatory effective date (and after the statutory effective date in paragraph (a) of this Q&A–21) if there has not been any deemed distribution of the loan before the transition date or if the conditions of paragraph (c)(2) of this Q&A–21 are satisfied with respect to the loan.

(2) *Consistency transition rule for certain loans deemed distributed before the regulatory effective date.* (i) The rules in this paragraph (c)(2) apply to a loan made before the regulatory effective date (and after the statutory effective date in paragraph (a) of this Q&A–21) if there has been any deemed distribution of the loan before the transition date.

(ii) The plan is permitted to apply Q&A–19 and Q&A–20 of this section to the loan beginning on any January 1, but only if the plan reported, in Box 1 of Form 1099–R, for a taxable year no later than the latest taxable year that would be permitted under this section, a gross distribution of an amount at least equal to the initial default amount. For purposes of this section, the initial default amount is the amount that would be reported as a gross distribution under Q&A–4 and Q&A–10 of this section and the transition date is the January 1 on which a plan begins applying Q&A–19 and Q&A–20 of this section to a loan.

(iii) If a plan applies Q&A–19 and Q&A–20 of this section to such a loan, then the plan, in its reporting and withholding on or after the transition date, must not attribute investment in the contract (tax basis) to the participant or beneficiary based upon the initial default amount.

(iv) This paragraph (c)(2)(iv) applies if—

(A) The plan attributed investment in the contract (tax basis) to the participant or beneficiary based on the deemed distribution of the loan;

(B) The plan subsequently made an actual distribution to the participant or beneficiary before the transition date; and

(C) Immediately before the first actual distribution made on or after the transition date, the initial default amount (or, if less, the amount of the investment in the contract so attributed) exceeds the sum of the participant's or beneficiary's investment in the contract (tax basis) immediately before the transition date plus any increase in the participant's or beneficiary's investment in the contract (tax basis) on or after the transition date. If this paragraph (c)(2)(iv) applies, the plan must treat the excess (the loan transition amount) as a loan amount that remains outstanding and must include the excess in the participant's or beneficiary's income at the time of the actual distribution.

(3) *Examples.* The rules in paragraph (c)(2) of this Q&A-21 are illustrated by the following examples, which are based on the assumptions described in ASSUMPTIONS FOR EXAMPLES (and, except as specifically provided in the examples, also assume that no distributions are made to the participant and that the participant has no investment in the contract with respect to the plan). *Example 1, Example 2,* and *Example 4* illustrate the application of these rules to a plan that, before the transition date, did not treat interest accruing after the initial deemed distribution as resulting in additional deemed distributions under section 72(p). *Example 3* illustrates the application of

these rules to a plan that, before the transition date, treated interest accruing after the initial deemed distribution as resulting in additional deemed distributions under section 72(p).

Example 1. (a) In 1995, when a participant's account balance under a plan is $50,000, the participant receives a loan from the plan. The participant makes the required repayments until 1996 when there is a deemed distribution of $20,000 as a result of a failure to repay the loan. For 1996, as a result of the deemed distribution, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $20,000 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of Q&A–21 of this section) and, in Box 2 of Form 1099–R, a taxable amount of $20,000. The plan then records an increase in the participant's tax basis for the same amount ($20,000). Thereafter, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1996 deemed distribution. Thus, as of December 31, 1998, the total taxable amount reported by the plan as a result of the deemed distribution is $20,000 and the plan's records show that the participant's tax basis is the same amount ($20,000). As of January 1, 1999, the plan decides to apply Q&A–19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is zero. Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2000 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(b) For the year 2000, the plan must report a gross distribution of $60,000 on Box 1 of Form 1099–R and a taxable amount of $60,000 in Box 2 of Form 1099–R.

Example 2. The facts are the same as in *Example 1*, except that in 1996, immediately prior to the deemed distribution, the participant's account balance under the plan totals $50,000 and the participant's tax basis is $10,000. For 1996, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $20,000 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of Q&A–21 of this section) and reports, in Box 2 of Form 1099-R, a taxable amount of $16,000 (the $20,000 deemed distribution minus $4,000 of tax basis ($10,000 times ($20,000/$50,000)) allocated to the deemed distribution). The plan then records an increase in tax basis equal to the $20,000 deemed distribution, so that the participant's remaining tax basis as of December 31, 1996 totals $26,000 ($10,000 minus $4,000 plus $20,000). Thereafter, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1996 deemed distribution. Thus, as of December 31, 1998, the total taxable amount reported by the plan as a result of the deemed distribution is $16,000 and the plan's records show that the participant's tax basis is $26,000. As of January 1, 1999, the plan decides to apply Q&A–19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is $6,000. Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2000 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(b) For the year 2000, the plan must report a gross distribution of $60,000 on Box 1 of Form 1099–R and a taxable amount of $54,000 in Box 2 of Form 1099–R.

Example 3. (a) In 1990, when a participant's account balance in a plan is $100,000, the participant receives a loan of $50,000 from the plan. The participant makes the required loan repayments until 1992 when there is a deemed distribution of $28,919 as a result of a failure to repay the loan. For 1992, as a result of the deemed distribution, the plan reports, in Box 1 of Form 1099–R, a gross distribution of $28,919 (which is the initial default amount in accordance with paragraph (c)(2)(ii) of Q&A–21 of this section) and, in Box 2 of Form 1099–R, a taxable amount of $28,919. For 1992, the plan also records an increase in the participant's tax basis for the same amount ($28,919). Each year thereafter through 1998, the plan reports a gross distribution equal to the interest accruing that year on the loan balance, reports a taxable amount equal to the interest accruing that year on the loan balance reduced by the participant's tax basis allocated to the gross distribution, and records a net increase in the participant's tax basis equal to that taxable amount. As of December 31, 1998, the taxable amount reported by the plan as a result of the loan totals $44,329 and the plan's records for purposes of section 72 show that the participant's tax basis totals the same amount ($44,329). As of January 1, 1999, the plan decides to apply Q&A–19 of this section. Accordingly, it reduces the participant's tax basis by the initial default amount of $28,919, so that the participant's remaining tax basis in the plan is $15,410 ($44,329 minus $28,919) as of December 31, 1999. Thereafter, the amount of the outstanding loan is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2000 and receives a distribution of the full account balance under the plan consisting of $180,000 in cash and the loan receivable equal to the $28,919 outstanding loan amount in 1992 plus interest accrued thereafter to the payment date in 2000. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $180,000 in cash.

(b) For the year 2000, the plan must report a gross distribution of $180,000 in Box 1 of Form 1099-R and a taxable amount of $164,590 in Box 2 of Form 1099–R ($180,000 minus the remaining tax basis of $15,410).

Example 4. (a) The facts are the same as in Example 1, except that in 1997, after the deemed distribution, the participant receives a $10,000 hardship distribution. At the time of the hardship distribution, the participant's account balance under the plan totals $50,000. For 1997, the plan reports, in Box 1 of Form 1099-R, a gross distribution of $10,000 and, in Box 2 of Form 1099–R, a taxable amount of $6,000 (the $10,000 actual distribution minus $4,000 of tax basis ($10,000 times ($20,000/$50,000)) allocated to this actual distribution). The plan then records a decrease in tax basis equal to $4,000, so that the participant's remaining tax basis as of December 31, 1997 totals $16,000 ($20,000 minus $4,000). After 1996, the plan disregards, for purposes of section 72, the interest that accrues on the loan after the 1996 deemed distribution. Thus, as of December 31, 1998, the total taxable amount reported by the plan as a result of the deemed distribution plus the 1997 actual distribution is $26,000 and the plan's records show that the participant's tax basis is $16,000. As of January 1, 1999, the plan decides to apply Q&A–19 of this section to the loan. Accordingly, it reduces the participant's tax basis by the initial default amount of $20,000, so that the participant's remaining tax basis in the plan is reduced from $16,000 to zero. However, because the $20,000 initial default amount exceeds $16,000, the plan records a loan transition amount of $4,000 ($20,000 minus $16,000). Thereafter, the amount of the outstanding loan, other than the $4,000 loan transition amount, is not treated as part of the account balance for purposes of section 72. The participant attains age 59-1/2 in the year 2000 and receives a distribution of the full account balance under the plan consisting of $60,000 in cash and the loan receivable. At that time, the plan's records reflect an offset of the loan amount against the loan receivable in the participant's account and a distribution of $60,000 in cash.

(b) In accordance with paragraph (c)(2)(iv) of Q&A–21 of this section, the plan must report in Box 1 of Form 1099–R a gross distribution of $64,000 and in Box 2 of Form 1099–R a taxable amount for the participant for the year 2000 equal to $64,000 (the sum of the $60,000 paid in the year 2000 plus $4,000 as the loan transition amount).

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 31, 1997, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1998, 63 F.R. 42)

Notice of Proposed Rulemaking

FICA and FUTA Taxation of Amounts Under Employee Benefit Plans

REG–209484–87; REG–209807–95

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains a revision to the proposed regulations under section 3121(v)(2) of the Internal Revenue Code of 1986, relating to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as "wages" for purposes of the taxes imposed by the Federal Insurance Contributions Act (FICA). This document extends the proposed general effective date of the regulations to January 1, 1998. The extension also applies to the proposed regulations under section 3306(r)(2), relating to when amounts deferred under or paid from certain nonqualified deferred compensation plans are taken into account as "wages" for purposes of the taxes imposed by the Federal Unemployment Tax Act (FUTA), due to the cross-reference therein to the provisions of the proposed regulations under section 3121(v)(2).

DATES: Written comments and requests for a public hearing must be received by March 24, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (EE–142–87), room 5228, Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044. In the alternative, submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM: CORP:R (REG–209484–87), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

FOR FURTHER INFORMATION CONTACT: Janine Cook, (202) 622-6040 (not a toll-free number), concerning the regulations, and Michael Slaughter, (202) 622-7190 (not a toll-free number), concerning submissions.

SUPPLEMENTARY INFORMATION:

Background

This document contains a revision to the proposed amendments to the Employment Tax Regulations (26 CFR part 31) under section 3121(v)(2) of the Internal Revenue Code of 1986 (Code), relating to the Federal Insurance Contributions Act (FICA) tax treatment of amounts deferred under or paid from certain nonqualified deferred compensation plans. The proposed regulations were published in the Federal Register on January 25, 1996 (61 F.R. 2194), with a proposed general effective date of January 1, 1997. This document extends the proposed general effective date to January 1, 1998. The same issue of the Federal Register contained proposed amendments to the Employment Tax Regulations under section 3306(r)(2) of the Code, relating to the Federal Unemployment Tax Act (FUTA) tax treatment of amounts deferred under or paid from certain nonqualified deferred compensation plans (61 F.R. 2214). The proposed regulations under section 3306(r)-(2) cross-reference the provisions of the proposed regulations under section 3121(v)(2), including the proposed general effective date. Consequently, the extension of the effective date under the proposed regulations under section 3121(v)(2) automatically applies to the proposed regulations under section 3306(r)(2).

The project numbers assigned to the notices of proposed rulemaking setting forth the proposed regulations under section 3121(v)(2) and section 3306(r)(2) were EE–142–87 and EE–55–95, respectively. Due to changes in the Internal Revenue Service's regulations numbering system, the project numbers for this notice of proposed rulemaking have been changed to REG–209484–87 and REG–209807–95, respectively, as reflected at the beginning of this document.

Explanation of Provisions

Section 31.3121(v)(2)–1(g)(1)(i) of the proposed regulations provides that the proposed general effective date of the regulations is January 1, 1997. Because the final regulations have not been issued, this document contains an amendment to the proposed regulations to extend the proposed general effective date to January 1, 1998. This extension of the proposed general effective date also applies to § 31.3306(r)(2)–1 of the proposed regulations due to the cross-reference therein to the provisions in the proposed regulations under section 3121(v)(2).

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Code, this notice of proposed rulemaking will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Requests for a Public Hearing

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

Drafting Information

The principal author of this revision to the proposed regulations is Janine Cook, Office of the Associate Chief Counsel (Employee Benefits and Exempt Organizations), IRS. However, other personnel from the IRS and Treasury Department participated in its development.

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Proposed Amendments to the Regulations

Accordingly, 26 CFR part 31 is proposed to be amended as follows:

PART 31—EMPLOYMENT TAXES AND COLLECTION OF INCOME TAX AT SOURCE

Paragraph 1. The authority citation for part 31 continues to read in part as follows:

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

Par. 2. Section 31.3121(v)(2)–1 as proposed to be added at 61 FR 2199, January 25, 1996, is amended by revising paragraph (g)(1)(i) to read as follows:

§ 31.3121(v)(2)–1 Treatment of amounts deferred under certain nonqualified deferred compensation plans.

* * * * *

(g) *Effective date and transition rules*—(1) *General effective date*—(i) *Effective date.* Except as otherwise provided in this paragraph (g) or in §31.3121(v)–2, this section is effective for amounts deferred and benefits paid on or after January 1, 1998.

* * * * *

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

(Filed by the Office of the Federal Register on December 23, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 24, 1997, 62 F.R. 67304)

Foundations Status of Certain Organizations

Announcement 98–11

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:

Childrens Resource Center Inc., East Point, GA
Coal Creek-Rock Creek Trails Foundation, Louisville, CO
Coal Plasma Energy Conversion Inc., Alexandria, VA
Coalition Advancing Universal Social Equality Cause Inc., Jackson, MS
Coalition for Citizens With Disabilities, Incorporated, Jackson, MS
Coalition for a Free America LTD, Peoria, IL
Coalition for Human Priorities of New Jersey, East Orange, NJ
Coalition for Progress Foundation, Inc., Miami, FL
Coalition for the Earths Environment of Dallas, Dallas, TX
Community Organization for Puerto Rican Affairs, Inc., Fort Launderdale, FL
Community Program of Our Fathers House Inc., Houston, TX
Community Reconstruction Institute Inc., Plantation, FL
County of Dixon School District 24, Newcastle, NE
Dwayne S. Brown Foundation Inc., Washington, DC
East Russell Childcare and Development Center Inc., Louisville, KY
E & J Nichols Inc., Baytown, TX
E.C. Reems Womens International Ministries, Dayton, OH
E.C. Wood Foundation, Austin, TX
Emma Inman Williams Scholarship Fund, Jackson, TN
Emmanuel Housing Center, Dothan, AL
Emmas Clinic Inc. Center for Counseling and Learning, Colorado Springs, CO
Flint Fast Track, Flint, MI
Flora T. Benshoof Foundation, Westminster, CO
Florence Community Band Inc., Florence, KY
Florence Community Chorus Inc., Richwood, KY
Florence Interfaith Outreach, Florence, SC
Florida Association of Teachers of English to Speakers of Other Languages Inc., Miami, FL
Florida Community Housing Assistant Corp, Fort Lauderdale, FL
Florida Health Care Utilities Inc., Hialeah, FL
Florida Indigent Medical Program Inc., Miami, FL
Greater Corktown Economic Development Corporation, Detroit, MI
Greater Des Moines Sports Authority, Des Moines, IA
Greater Sugar Land Pony Colt League Inc., Sugar Land, TX
Greater Tampa Youth Hockey Inc., Oldsmar, FL
Greenbrier Music Festival Inc., Charleston, WV
Greater Warner Friends of the Library Inc., Warner, OK
Historic Preservation of Porter County, Valparaiso, IN
Historic Watertown Inc., Watertown, TN
Historical Society of the American Memorial Park, Saipan, MP
Hmong National Development Inc., Omaha, NE
Ho-Ho-Kus Education Foundation Inc., Ho Ho Kus, NJ
Joint SIU Conference, Tallahassee, FL
Jomar Health Services Inc., Lake Charles, LA
Jones City Park Development Inc., Jones, OK
Jonesboro Area Athletic Assoc. Government Cir., Jonesboro, GA
Josephs Journeys Inc., Charlotte, NC
Joy in Learning Educational Center Incorporated, Gary, IN
Joy International Ministries Inc., Oklahoma City, OK
Joy Outdoor Ministries, Glendale, AZ
Joyful Toyful Fiesta Inc., Baytown, TX
Khmer Society & Association, Houston, TX
Kids & Kicks Soccer Club, Columbia, IL
Kids at Hart Inc., Hart, MI
Kids Express, Clancy, MT
Kids Express Daycare Service Inc., Jackson, MS
Kids First Charitable Trust, Carrollton, TX
Laredo Medical Foundation, Laredo, TX
Larry Laoretti Kids Classic Inc., Winter Park, FL
Las Cruces Aquatic Team Incorporated, Las Cruces, NM
Lincoln Economic Area Development Association, Roselawn, IN
Link Up Broward Inc., Ft. Lauderdale, FL
Lions Arms II Inc., Louisville, KY
Little Falls Main Street Inc., Little Falls, MN
Little Hill House Inc., Grandbury, TX
Little Ones Inc., Poydras, LA
Louisiana School for the Deaf Foundation, Baton Rouge, LA
Louisville East Community Development Corporation, Louisville, KY
Louisville Scottish Country Dance Society Inc., Louisville, KY
Mesa Centennial Campus for Girls Inc., Pueblo, CO

Metanoia Inc., Belle Rose, LA
Metro Charitable Auctions Inc., Louisville, KY
Micaiah Ministries Inc., Tahlequah, OK
Mid-Michigan Canine Search and Rescue Team, Farmington Hills, MI
Mid-Ohio Psychological Services Inc., Lancaster, OH
Millennium Foundation, Ridgewood, NJ
Millfield Community Organization, Millfield, OH
Milwaukee Area Recovery Center Inc., Milwaukee, WI
Milwaukee Center for Cultural Dance and Awareness, Inc., Milwaukee, WI
Milwaukee Women in the Trades Inc., Shorewood, WI
Morehouse D A R E Inc., Bastrop, LA
Motorcycle-Dial-a-Ride Inc., Chanhassen, MN
Moultrie Sculpture Committee Inc., Washington, DC
Mount Auburn Community Council of Cincinnati, Inc., Cincinnati, OH
Mount Carmel International Breaking Chain Prison Ministry, Inc., Jersey City, NJ
National Longevity Foundation, West Palm Beach, FL
National Organization of Single Mothers Incorporated, Midland, NC
National Pastoral Center for Vietnamese Apostolate, Inc., New Orleans, LA
National Pet Disaster Fund, Harrisburg, PA
Newarks Coalition of Small Business Development Corporation, Inc., Newark, NJ
Newport Campus-Arkansas State University Beebe Charitable Foundation, Inc., Newport, AR
Newton County Housing Council, Jasper, AR
Nigerian Cultural Association, St. Louis, MO
Nightcare at the Bear Minimum-A PM Childcare Service, Inc., Cleveland, OH
Nikki Childrens Home, Houston, TX
Nims Neighborhood Association, Muskegon, MI
Nizhoni Smiles, Shiprock, NM
Noble Hill Wheeler Memorial Association, Inc., Cartersville, GA
Noblesville Babe Ruth Bambino League, Inc., Noblesville, IN
Nomad Boosters Inc., Davidson, NC
Nordstrom Foundation, Red Lodge, MT

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.

Completing Form 8582 Worksheets for More Than One Passive Activity With Schedule D (Form 1040) Transactions

Announcement 98–12

The 1997 instructions for Form 8582, Passive Activity Loss Limitations, included an example of how to complete the worksheets for Form 8582 when the filer has one passive activity with Schedule D (Form 1040) transactions.

In response to requests for clarification on how to complete the worksheets if the filer has more than one passive activity with Schedule D (Form 1040) transactions, we have developed the following example:

Example of Schedule D (Form 1040) Transactions

The taxpayer had the following Schedule D (Form 1040) transactions from two activities in 1997.

Activity I

A passive activity prior year unallowed long-term capital loss (a 28% rate loss) of ($1,000), and a loss on a May 8, 1997, sale of an asset held more than 12 months (a 20% rate loss) of ($3,000).

Activity II

A loss on a July 30, 1997, sale of an asset held more than 12 months but not more than 18 months (a 28% rate loss) of ($230), and net income of $1,100 from Schedule E (Form 1040).

Worksheet 2

The activities were reported separately on Worksheet 2. Activity I had an overall loss of ($4,000) (current year net loss of ($3,000) and a prior year unallowed loss of ($1,000)). Activity II had an overall gain of $870 (current year net income of $1,100 less current year net loss of ($230)). Line 11 of Form 8582 shows a loss allowed of ($1,100).

Worksheet 4

Activity I has an unallowed loss of ($3,130). (Line 3 of Form 8582 ($3,130) less line 9 of Form 8582 (–0–) × 100%). All of the ($230) loss is allowed for Activity II.

Worksheet 6

Use Worksheet 6 to figure the portion of the unallowed loss attributable to the 28% rate loss and the portion to the 20% rate loss.

Enter the loss attributable to the 28% rate loss ($1,000) and the loss attributable to the 20% rate loss ($3,000) as separate entries in Worksheet 6 (i.e., as if they were going to be reported on a different form or schedule). Then figure the ratio of each loss to the total of the two losses as follows. $1,000/$4,000 = .25. $3,000/$4,000 = .75. Multiply each of these ratios by the unallowed loss for Activity I shown in column (c) of Worksheet 4 ($3,130).

Unallowed losses for Activity I:

28% rate loss: .25 × $3,130 = $782.50
20% rate loss: .75 × $3,130 = $2,347.50

Allowed losses for Activity I:

28% rate loss: $1,000 – $782.50 = $217.50
20% rate loss: $3,000 – $2,347.50 = $652.50

The total loss allowed for Activity I ($870.00) is entered in column (f), Part II, Schedule D (Form 1040) and the 28% rate loss ($217.50) is entered in column (g). Keep a record of the unallowed 28% and 20% rate losses to figure the passive activity loss for these transactions next year.

Revision of Form 3115

Announcement 98–13

Form 3115, Application for Change in Accounting Method, and the Instructions

for Form 3115 have been revised. This November 1997 revision is the current Form 3115 and replaces the February 1996 version of Form 3115. Copies of the revised form and instructions are available at most IRS offices.

Applicants may order Form 3115 by telephone or they may use other IRS electronic information services to get copies.

Request by—	Number or Address
Telephone	1-800-TAX-FORM (1-800-829-3676)
Personal computer:	
World Wide Web	www.irs.ustreas.gov
File Transfer Protocol	ftp.irs.ustreas.gov
Telnet	iris.irs.ustreas.gov
Direct Dial (by modem)	703-321-8020

New Forms 5305–R, 5305–RA, 5305–E, and 5305–EA Now Available

Announcement 98–14

Form 5305–R, Roth Individual Retirement Trust Account, and **Form 5305–RA,** Roth Individual Retirement Custodial Account, are two new model trust and custodial account agreements. Section 302 of the Taxpayer Relief Act of 1997 (the "Act") created the Roth individual retirement account (Roth IRA). A Roth IRA is established after Form 5305–R or 5305–RA is executed by both the grantor and the trustee (for Form 5305–R) or the depositor and the custodian (for Form 5305–RA). The forms meet the requirements of section 408A of the Internal Revenue Code (the "Code").

Form 5305–E, Education Individual Retirement Trust Account, and **Form 5305–EA,** Education Individual Retirement Custodial Account, are also two new model trust and custodial account agreements. The education individual retirement account (Ed IRA) is established under section 213 of the Act. An Ed IRA is established after Form 5305–E or 5305–EA is executed by both the grantor and the trustee (for Form 5305–E) or the depositor and the custodian (for Form 5305–EA). The forms meet the requirements of Code section 530.

Copies of Forms 5305–R, 5305–RA, 5305–E, and 5305–EA are available at most IRS offices. Applicants may order the forms by telephone or they may use other IRS electronic information services to get copies.

Request by—	Number or Address
Telephone	1-800-TAX-FORM (1-800-829-3676)
Personal computer:	
World Wide Web	www.irs.ustreas.gov
File Transfer Protocol	ftp.irs.ustreas.gov
Telnet	iris.irs.ustreas.gov
Direct Dial (by modem)	703-321-8020

Announcement of the Consent Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Date of Suspension
Trempus Jr., Joseph	Cabot, PA	CPA	October 1, 1997 to February 28, 1998
Tyler, Delbert D.	Monroeville, PA	CPA	October 23, 1997 to April 22, 2000
Gillmore, George P.	Hampton, NJ	CPA	Indefinite from October 10, 1997
Kamin, James C.	Chicago, IL	CPA	December 1, 1997 to May 31, 1999
Hubbard, Edward	Chicago, IL	Attorney	Indefinite from December 1, 1997
Retzlaff, Gene	Hortonville, WI	Enrolled Agent	December 1, 1997 to May 31, 1998
Conklin, Dennis M.	Arlington Hghts, IL	CPA	December 3, 1997 to December 2, 1998
Bowen, Roger H.	Lake Bluff, IL	CPA	December 4, 1997 to December 3, 1999
Ciconte, William	Wilmington, DE	Enrolled Agent	December 10, 1997 to December 9, 2000
Lopin, Paul I.	Chicago, IL	CPA	Indefinite from December 11, 1997
Goldstein, Benjamin	Des Plaines, IL	CPA	December 12, 1997 to June 11, 1998
Olsen Jr., Burton	Rancho Cordova, CA	CPA	December 15, 1997 to June 14, 1998
Hickman, Michael	Lawrence, KS	CPA	December 16, 1997 to April 15, 1998
Grant, Arthur J.	Morris Plains, NJ	CPA	January 1, 1998 to December 31, 2000
Zielinski, Henry	Woodstock, IL	CPA	January 1, 1998 to June 30, 1999
Rosales, John	Batavia, IL	CPA	January 1, 1998 to April 30, 1998
Reinstein, Maxwell	Potomac, MD	CPA	January 1, 1998 to March 31, 1998
Payne, Charlotte	Breckenridge, CO	CPA	January 1, 1998 to December 31, 1999
Ibrahim, Mongy	Raleigh, NC	CPA	January 1, 1998 to December 31, 1998
Koutek, Paul J.	Westchester, IL	CPA	January 1, 1998 to August 31, 1998
Doherty, Steven	Chicago, IL	CPA	January 1, 1998 to December 31, 1999
Deren, Patricia	Lackawanna, NY	Attorney	January 1, 1998 to December 31, 1998
Calhoun, Sandra	Louisville, KY	CPA	January 1, 1998 to March 31, 1998
Thurman, Stephen	Arcadia, CA	CPA	January 1, 1998 to December 31, 1998
Davidson, Mark	Tulsa, OK	CPA	January 15, 1998 to October 14, 1999
Hequembourg, Donald	Glencoe, MO	CPA	January 20, 1998 to July 19, 1998

Announcement of the Expedited Suspension of Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries From Practice Before the Internal Revenue Service

Under title 31 of the Code of Federal Regulations, section 10.76, the Director of Practice is authorized to immediately suspend from practice before the Internal Revenue Service any practitioner who, within five years from the date the expedited proceeding is instituted, (1) has had a license to practice as an attorney, certified public accountant, or actuary suspended or revoked for cause; or (2) has been convicted of any crime under title 26 of the United States Code or, of a felony under title 18 of the United States Code involving dishonesty or breach of trust.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by, or sharing fees with, any practitioner disbarred or suspended from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify practitioners under expedited suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent, or enrolled actuary, and date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent, or enrolled actuary so suspended and will be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions of the applicable regulations:

Name	Address	Designation	Date of Suspension
Christensen, Reed K.	Roseville, CA	Enrolled Agent	Indefinite from December 16, 1997

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.

Numerical Finding List[1]

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[1] A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1997–27 through 1997–52 will be found in Internal Revenue Bulletin 1998–1, dated January 5, 1998.

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[1] A cumulative finding list for previously published items mentioned in Internal Revenue Bulletins 1997–27 through 1997–52 will be found in Internal Revenue Bulletin 1998–1, dated January 5, 1998.