

Internal Revenue bulletin

Bulletin No. 1998-42
October 19, 1998

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. 8784, page 4.

Final and temporary regulations under section 274 of the Code relate to the use of mileage allowances to substantiate automobile business expenses.

T.D. 8785, page 5.

Final regulations under section 861 of the Code relate to the tax treatment of certain transactions involving the transfer of computer programs.

EXCISE TAX

Announcement 98-90, page 21.

Public comments are requested on proposed changes to Form 8849, Claim for Refund of Excise Taxes.

ADMINISTRATIVE

REG-122488-97, page 19.

Proposed regulations under section 274 of the Code relate to the use of mileage rates to substantiate automobile business expenses.

Finding Lists begin on page 33.

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Department of the Treasury
Internal Revenue Service

Mission of the Service

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

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

Statement of Principles of Internal Revenue Tax Administration

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

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

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

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

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

Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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

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

26 CFR 1.274(d)-1: Substantiation requirements.

T.D. 8784

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Substantiation of Business Expenses—Use of Mileage Allowances to Substantiate Automobile Expenses

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary and final regulations.

SUMMARY: This document contains temporary and final regulations relating to the use of mileage allowances to substantiate automobile business expenses. The regulations affect payors who make payments and employees who receive payments under reimbursement or other expense allowance arrangements for the business use of an automobile.

DATES: *Effective date:* These regulations are effective October 1, 1998.

Applicability date: These regulations apply to transportation expenses paid or incurred after December 31, 1997.

FOR FURTHER INFORMATION CONTACT: Donna M. Crisalli, (202) 622-4920 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background and Explanation of Provisions

Section 274(d) provides that a taxpayer is not allowed a deduction or credit for certain expenses unless the expense is substantiated. These substantiation requirements apply to the expenses of use of any listed property (defined in section 280F(d)(4)), which includes any passenger automobile and any other property used as a means of transportation. The

Secretary may issue regulations that provide that some or all of the substantiation requirements will not apply to expenses that do not exceed a prescribed amount.

Section 1.274(d)-1 provides, in part, that the Commissioner may prescribe rules under which mileage allowances reimbursing ordinary and necessary expenses of local travel and transportation while traveling away from home will satisfy the substantiation requirements of §1.274-5T(c), and the requirements of an adequate accounting to the employer for purposes of §1.274-5T(f)(4). However, §1.274(d)-1(a)(3) provides that such mileage allowances are available only to the owner of a vehicle.

New §1.274(d)-1T applies these substantiation rules to mileage allowances for business use of an automobile after December 31, 1997, without the limitation in §1.274(d)-1(a)(3) that a mileage allowance is available only to the owner of a vehicle. See Rev. Proc. 97-59 (1997-52 I.R.B. 24), for rules that implement these regulations. The regulations also adopt new §1.62-2T(e)(2) to incorporate this new rule.

Special Analyses

It has been determined that these temporary and final regulations are 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, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary and final regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal authors of these regulations are Edwin B. Cleverdon and Donna M. Crisalli of the Office of the Assistant Chief Counsel (Income Tax and Accounting). However, other personnel from the

IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is amended as follows:

PART 1—INCOME TAXES

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

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

Section 1.274(d)-1 also issued under 26 U.S.C. 274(d).

Section 1.274(d)-1T also issued under 26 U.S.C. 274(d). * * *

Par. 2. In §1.62-2, paragraph (m) is amended by adding a sentence at the end of the paragraph to read as follows:

§1.62-2 Reimbursement and other expense allowance arrangements.

* * * * *

(m) * * * Paragraph (e)(2) of this section applies to payments made under reimbursement or other expense allowance arrangements received by an employee with respect to expenses paid or incurred on or before December 31, 1997. For payments with respect to expenses paid or incurred after December 31, 1997, see §1.62-2T(e)(2).

Par. 3. Section 1.62-2T is added to read as follows:

§1.62-2T Reimbursement and other expense allowance arrangements (temporary).

(a) through (e)(1) [Reserved]. For further guidance, see §1.62-2(a) through (e)(1).

(e)(2) *Expenses governed by section 274(d).* For further guidance, see §1.62-2(e)(2) except that each reference to §1.274(d)-1 is deemed to be a reference to §1.274(d)-1T.

(e)(3) through (l) [Reserved]. For further guidance, see §1.62-2(e)(3) through (l).

(m) *Effective dates.* Paragraph (e)(2) of this section applies to payments made

under reimbursement or other expense allowance arrangements received by an employee with respect to expenses paid or incurred after December 31, 1997. For payments with respect to expenses paid or incurred on or before December 31, 1997, see §1.62-2(e)(2).

Par. 4. Section 1.274(d)-1 is amended by adding paragraph (b) to read as follows:

§1.274(d)-1 Substantiation requirements.

* * * * *

(b) *Effective date.* This section applies to allowances described in paragraph (a)(2) of this section for expenses paid or incurred on or before December 31, 1997. For allowances for expenses paid or incurred after December 31, 1997, see §1.274(d)-1T.

Par. 5. Section 1.274(d)-1T is added to read as follows:

§1.274(d)-1T Substantiation requirements (temporary).

(a)(1) and (2) [Reserved]. For further guidance, see §1.274(d)-1(a)(1).

(a)(3) [Reserved].

(b) *Effective date.* This section applies to allowances described in §1.274(d)-1(a)(2) for expenses paid or incurred after December 31, 1997. For allowances for expenses paid or incurred on or before December 31, 1997, see §1.274(d)-1(a).

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

Approved September 14, 1998.

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

(Filed by the Office of the Federal Register on September 30, 1998, 8:45 a.m., and published in the issue of the Federal Register for October 1, 1998, 63 F.R. 52600)

Section 861.—Income From Sources Within the United States

26 CFR 1.861-18: Classification of transactions involving computer programs.

T.D. 8785

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

Classification of Certain Transactions Involving Computer Programs

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains regulations relating to the tax treatment of certain transactions involving the transfer of computer programs. The regulations provide rules for classifying such transactions as sales or licenses of copyright rights, sales or leases of copyrighted articles, or the provision of services, or of know-how, under certain provisions of the Internal Revenue Code and tax treaties. These regulations are necessary to give taxpayers guidance on the taxation of computer program transactions. These regulations affect taxpayers engaging in certain transactions involving computer programs.

DATES: *Effective date.* These regulations are effective October 2, 1998.

Applicability date. These regulations apply to transactions occurring pursuant to contracts entered into on or after December 1, 1998. Taxpayers may elect to apply this section to transactions occurring pursuant to contracts entered into in taxable years ending on or after October 2, 1998. Taxpayers may also elect to apply this section to transactions occurring in taxable years ending on or after October 2, 1998, pursuant to contracts entered into before October 2, 1998, provided the taxpayer would not be required under this section to change its method of accounting, or the taxpayer would be required to change its method of accounting but the resulting section 481 adjustment would be zero.

FOR FURTHER INFORMATION CONTACT: Anne Shelburne, (202) 622-3880 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information in this

final rule has been reviewed and, pending receipt and evaluation of public comments, approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act (44 U.S.C. 3507) and assigned control number 1545-1594. 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 OMB.

The collection of information in this regulation is in §1.861-18(k) of the regulations. This information is required to permit taxpayers to obtain an automatic change in method of accounting. This information will be used to enable the IRS to determine if taxpayers were entitled to an automatic change in method of accounting. The likely respondents are organizations.

Comments concerning the collection of information should be directed to OMB, Attention: 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, OP:FS:FP, Washington, DC 20224. Any such comments should be submitted not later than December 1, 1998. Comments are specifically requested concerning:

Whether the collection of information is necessary for the proper performance of the functions of the IRS, including whether the information will have practical utility;

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

How to enhance the quality, utility, and clarity of the information collected;

How to minimize the burden of complying with the collection of information, including 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 burden per respondent is reflected in the burden of Form 3115.

Books or records relating to this 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 final regulations to be added to the Income Tax Regulations (26 CFR part 1) under section 861 of the Internal Revenue Code (Code). These regulations clarify the treatment under certain provisions of the Code and tax treaties of income from transactions involving computer programs.

On November 13, 1996, proposed regulations [REG-251520-96 (1996-2 C.B. 511)] were published in the **Federal Register** (61 F.R. 58152). The IRS received written comments on the proposed regulations and held a public hearing on March 19, 1997. Having considered the comments and the statements made at the hearing, the IRS and Treasury Department adopt the proposed regulations as modified by this Treasury decision. The comments and revisions are discussed below.

I. The Proposed Regulations.

The proposed regulations clarify certain rules for classifying transactions involving computer programs. The regulations generally require that a transaction involving a computer program be treated as being within one of four possible categories: (1) transfer of copyright rights, (2) transfer of a copyrighted article, (3) provision of services relating to development or modification of a computer program, or (4) provision of know-how relating to computer programming techniques.

The regulations distinguish between transfers of copyright rights and transfers of copyrighted articles based on the type of rights transferred to the transferee. They recognize that computer programs are subject to copyright protection under both U.S. and foreign copyright law. See the Copyright Act of 1976, as amended (17 U.S.C. 101 et. seq.); see also, EC Directive on Legal Protection of Computer Programs, Council Directive 91-250, 1991 J.O. (L 122), and the Berne Convention for the Capital Protection of Literary and Artistic Works, 25 U.S.T. 1341 (Paris Text, July 24, 1971). Copyright law grants certain exclusive rights to a copyright owner. The regulations classify a

transaction as the transfer of a copyright right if the transferee acquires one or more of the copyright rights identified in §1.861-18(c)(2) of the proposed regulations. If the transferee acquires a copy of a computer program but does not acquire any of the rights identified in §1.861-18(c)(2), the regulations classify the transaction as the transfer of a copyrighted article.

The proposed regulations further classify transfers of copyright rights as either a sale or a license of copyright rights. The proposed regulations require that this classification be made by examining whether, taking into account all facts and circumstances, all substantial rights in the copyright have passed to the transferee. The proposed regulations also require that transfers of copyrighted articles be further classified as either a sale or a lease of a copyrighted article. This classification is made by examining whether the benefits and burdens of ownership of the copyrighted article have passed to the transferee.

The specific rules of the proposed regulations are based on certain key principles: that the special features of computer programs should be recognized and that functionally equivalent transactions should be treated similarly. The regulations are also based on the principle that copyright law should be a factor in classifying transactions for tax purposes, but should not be determinative.

Finally, the proposed regulations contain 18 examples illustrating the rules.

II. Comments and Final Regulations.

1. Scope and Application of the Regulations.

a. General Scope.

The proposed regulations classify transactions in computer programs for certain international provisions of the Code. A number of comments addressed two types of issues involving the scope of the regulations: the treatment of computer programs under other tax provisions of the Code and the application of the principles of the proposed regulations to products other than computer programs.

As to the treatment of computer programs under other Code sections, comments were mixed. Several commenta-

tors requested that Treasury expand the scope of the final regulations to apply the regulations' principles for all U.S. tax purposes. Other commentators, however, urged caution, stating that issues raised under other Code sections should be resolved only by legislation or by revising the regulations under those other sections. Most commentators recommended applying the regulations for tax accounting purposes.

Some commentators requested that Treasury specifically address the relevance of the regulations in a specific context. For example, some commentators requested that the regulations clarify how the principles apply in determining the consequences of computer program transactions under tax treaties.

After consideration of these comments, the final regulations retain the scope of the proposed regulations. However, Treasury and the IRS are considering whether the principles of these regulations should apply to other tax provisions of the Code.

These regulations are intended to apply for purposes of applying and interpreting U.S. tax treaties. United States tax treaties provide that terms not defined in the treaty are defined by reference to domestic law. See e.g., U.S. Model Income Tax Convention of September 20, 1996, Article 3(2).

The second group of comments generally addressed expanding the scope of the regulations to apply to transactions in other types of digitized information. The proposed regulations are limited to classifying transactions in computer programs. Section 1.861-18(a)(3) of the proposed regulations defines a computer program as "...a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result." The definition includes any data base or similar item only "... if the data base or similar item is incidental to the operation of the computer program." Commentators expressed differing views as to how to define computer programs. Several commentators recommended that the definition be expanded to include data bases and content provided as part of the transaction. They note that advances in technology now permit significant amounts of content, that are not merely incidental, to be included in even inexpensive mass-marketed programs. Some

commentators recommended that the definition be expanded to include data bases or similar items even if not incidental, while some stated that data base products containing only a de minimis amount of software programming to facilitate access to the data should be excluded from the definition.

Several commentators requested that Treasury expand the regulations more generally, by applying the same or analogous principles in determining the tax consequences of transactions involving copyright rights and copyrighted articles to entertainment products, or to other digitized information.

The suggestions to expand the scope of the regulations, either by expanding the definition of computer programs or by applying the regulations to other types of digitized information, were not adopted. Instead, the final regulations generally retain the definition of computer programs found in the proposed regulations. It is intended that a computer program includes any media, user manuals or documentation, or similar items (in addition to data bases) if incidental to and routinely transferred along with the computer program. Treasury and the IRS are not aware of specific instances where the failure to expand the definition of computer program would result in inappropriate consequences to taxpayers for the portion of the transaction not governed by these regulations. Treasury and the IRS invite comments on this point.

The regulations also continue to apply only to cross-border transactions involving computer programs because Treasury and the IRS believe that such transactions raise the most pressing need for guidance. Treasury and the IRS may consider whether to apply the principles of these regulations to all transactions in digitized information as part of a separate guidance project.

b. *Relationship with Section 482.*

Numerous commentators requested clarification regarding the application of the regulations for purposes of section 482, requesting that transactions in copyright rights be treated as transactions in intangibles and transactions in copyrighted articles be treated as transactions in tangible property, even if delivered electronically.

This suggestion has not been adopted. Treasury and the IRS intend to further consider this issue and may provide additional guidance in the future. See generally, §1.482-3(f).

c. *Source of Income.*

Several commentators requested that Treasury provide explicit guidance in final regulations on how to source income arising from transactions in computer programs. Generally, under the current rules, the source of income from sales of property depends to varying extents upon both the type of property and, for inventory property, the place of sale, with the place of sale generally determined by the place where title to the property passes. See §1.861-7(c). Several commentators requested clarification of which source rule applies to various transactions in computer programs. The commentators also pointed out that the place of sale can be problematic when dealing with sales of computer programs, in part because typical license agreements do not refer to a transfer of property, and in part because an electronic transfer is generally not accompanied by the usual indicia of the transfer of title. Several commentators suggested that the place of sale should be deemed to be the location of the customer, or the place where the customer first obtains the opportunity to install the program onto its computer.

In response to comments, the final regulations provide specific source rules. The regulations provide that income from transactions that are classified as sales or exchanges of copyrighted articles will be sourced under sections 861(a)(6), 862(a)(6), 863, 865(a), 865(b), 865(c), or 865(e), as appropriate. Income derived from the sale or exchange of a copyright right will be sourced under sections 865(a), 865(c), 865(d), 865(e), or 865(h), as appropriate. Income derived from either the leasing of a computer program or the licensing of copyright rights in a computer program will be sourced under section 861(a)(4) or section 862(a)(4), as appropriate. As to the issue of determining the place of sale under the title passage rule of §1.861-7(c), the parties in many cases can agree on where title passes for sales of inventory property generally. Consistent with the overall policy of the

regulations, income from electronic transfers of computer programs that constitute inventory property, classified as sales of copyrighted articles, will be sourced under similar principles.

2. *Relevance of Foreign Law.*

Several commentators requested that Treasury clarify that classification of a transaction involving computer programs for U.S. tax purposes does not depend on foreign copyright law. In addition, one commentator requested that the regulations explicitly state that the terms used in the regulations, although taken from copyright law, will be interpreted in a manner consistent with the purposes of the regulations and Internal Revenue Code. In certain cases, terms taken from copyright law are specifically defined in the regulations so as to properly implement the regulations' underlying policy. Unless specifically defined in the regulations, legal standards taken from copyright law are intended to be given the same interpretation as under U.S. copyright law. Factual predicates for application of those standards, however, may be provided by referring to foreign copyright law. For example, if it were necessary to determine whether the transferee had acquired the right to create a derivative work based on a computer program protected under French copyright law, the facts of the case, i.e. the rights that the transferee may exercise, are determined under French law and the agreement between the parties. However, whether or not the transferee's rights constitute the right to create a derivative work for purposes of this regulation is determined by comparing those rights created under French law and the agreement between the parties to the U.S. law definition of the right to create a derivative work.

In addition, commentators requested clarification that the determination of whether a foreign tax imposed on transactions in computer programs is a compulsory payment, eligible for a foreign tax credit, is not affected by these regulations. Treasury believes clarification is unnecessary. These regulations do not in any way modify the requirement of §1.901-2(e)(5) that substantive and procedural provisions of foreign law (including applicable tax treaties) determine the taxpayer's liability

under foreign law for tax and thus whether an amount paid is a compulsory payment. Moreover, the regulations under section 904 recognize that a creditable foreign tax may be imposed on an item of income that is taxed at a different time or in a different manner in a foreign country than in the United States. See §1.904-6(a)(1).

3. Copyright Rights.

The proposed regulations, in §1.861-18(c)(2), describe four copyright rights: (i) the right to make copies for distribution to the public, (ii) the right to prepare derivative programs, (iii) the right to make a public performance of the program, and (iv) the right to publicly display the program. If a transfer of a computer program results in a transferee acquiring any one or more of the four listed rights, the regulations classify the transaction as a transfer of a copyright right. Although the commentators agreed that the right to make copies for distribution to the public is properly included, they made a number of comments regarding the three other copyright rights.

a. Derivative Programs.

Commentators stated that final regulations should clarify the right to prepare derivative programs. They recommended that the regulations more specifically describe the circumstances resulting in the transfer of such a copyright right.

Some commentators recommended that a transfer of the right to prepare a derivative program should not be treated as the transfer of a copyright right unless it is coupled with the right to distribute the derivative program to the public. That change, they say, would make the right more consistent with the right to reproduce copies, which results in the transfer of a copyright right only if it is coupled with the right to distribute to the public.

The final regulations do not adopt this recommendation. Although the final regulations disregard the *de minimis* right to make a derivative work, a substantial right to make a derivative work is appropriately treated as the transfer of a copyright right, regardless of whether it is coupled with the right to distribute to the public. The regulations generally follow copyright law in this respect. Although

the right to make copies constitutes the transfer of a copyright right only if coupled with the right to distribute to the public, the regulations treat the right to make copies differently from the other copyright rights because of the unique characteristics of computer programs, including the ease by which computer programs can be copied.

Another set of comments requests clarification of the effect of the transfer of programs that permit the user to distribute certain ancillary programs in conjunction with works created using the underlying program, or to incorporate certain program elements into new programs created using the underlying program. For example, certain programs, such as software development tools, permit the transferee to distribute certain ancillary programs or include certain segments of computer code in new programs created by the transferee using the development program. Similarly, transferees of computer programs are sometimes granted access to the program's source code in order to permit the transferee to correct minor errors or incompatibilities in the program.

Under the proposed regulations, the transfer of a software development tool or the grant of the right to correct minor errors by modifying the source code might constitute the right to create a derivative computer program, resulting in the transfer of a copyright right. Commentators argued, however, that in both cases, the overall character of the transaction was analogous to the transfer of a copyrighted article. Several commentators recommended that where limited portions of a development tool are included in an application program, the inclusion should be considered *de minimis*, and the resulting application program not treated as a derivative program of the program development tool.

In addition, several commentators recommended that where no independent value attaches to exploitation of the right to prepare derivative computer programs, such right should be treated as *de minimis*, and not considered in classifying the transaction.

In response to these comments, the final regulations provide in paragraph (c)(1)(ii) that the *de minimis* transfer of a copyright right will not be taken into account in determining whether a transac-

tion is considered the transfer solely of a copyrighted article. Example 17 clarifies that the right to use software development tools to create an insubstantial component of a new program constitutes such a *de minimis* copyright right. Example 18 clarifies that the right to modify the source code to correct minor errors and make minor adaptations to a computer program also constitutes a *de minimis* copyright right.

However, the final regulations do not provide that where no independent value attaches to the exploitation of the right to prepare derivative computer programs, such right must be treated as *de minimis*. Treasury and the IRS believe that in most cases where no independent value attaches to the grant of the right to prepare derivative computer programs, the right is *de minimis*. However, this may not be true in all cases and, therefore, this comment has not been adopted.

b. Public Performance and Display.

Several commentators urged Treasury to reserve in final regulations on two of the copyright rights, the right to make a public performance and the right to public display of the copyrighted work. Several commentators recommended that, if Treasury elects not to reserve, a transaction involving either right should result in treatment as a transfer of a copyright right only if the transfer is for commercial exploitation rather than for internal use.

Commentators also requested clarification of these rights in the entertainment area. They recommended the regulations state that the right to publicly perform or display the computer program should not be considered the transfer of a copyright right if the performance or display is limited to the advertisement of a copyrighted article, and does not permit the public display of the entire article.

These suggestions have not been adopted. However, Treasury and the IRS recognize that the definition of these rights in the context of computer programs is still developing, and in the future it may be necessary to revisit this issue. At the present time, Treasury and the IRS believe it is appropriate to continue to follow copyright law as to these rights. In many cases, however, the transfer of a right for public display or performance of

a computer program, such as marketing or advertising the program, to the extent it constitutes the transfer of a copyright right, would be considered a *de minimis* grant of a copyright right under §1.861-18(c)(1)(ii) of the final regulations, so that the transaction would not result in the transfer of a copyright right.

c. *Definition of to the Public.*

The proposed regulations list the right to make copies for distribution to the public as one of the four copyright rights. Commentators recommended that the regulations clarify the meaning of “to the public.” They recommended the definition exclude distribution to a related party, with related party defined to ensure that transfers to a non-controlled joint venture would not be considered distribution to the public. They also recommended that distribution to identified distributees not be considered distribution to the public.

Commentators also recommended the regulations state that distribution to the public does not mean distribution to employees. In addition, they urge Treasury to make explicit that internal distribution includes distribution to many employees, including employees of affiliates, at multiple locations.

In light of these comments, the final regulations provide in new paragraph (g)(3) that distribution to the public does not include distribution to a related person, which is defined for purposes of the regulation as a person who bears a relationship to the transferee specified in section 267(b)(3), (10), (11), or (12), or section 707(b)(1)(B), with “10 percent” substituted for “50 percent.” The term also excludes distribution to certain identified persons or to those with a legal relationship to the original transferee. The number of employees or independent contractors who are permitted to use the program in performance of services for the transferee is not relevant. The examples have also been amended to clarify that the number of permitted users, which includes employees of the transferee, within the group of related persons is not taken into account in determining whether the transferee has the right to distribute copies of the program to the public. See e.g., paragraph (h), *Example 11*.

4. *Definition of Copyrighted Article.*

The comments on this issue fell into two categories. One group of comments recommended that final regulations clarify the consequences of transferring a *de minimis* copyright right along with the transfer of a copyrighted article. The proposed regulations state in §1.861-18(c)(1)(ii) that if a person acquires a copy of a computer program but does not acquire any of the four copyright rights, the transfer is classified as a transfer of a copyrighted article. Several commentators requested that the regulations clarify the statement to say that if the transfer includes only a *de minimis* copyright right, the transfer is classified as a transfer of a copyrighted article. As discussed above, in response, the final regulations provide that if the transfer includes only a *de minimis* copyright right, the transfer is classified as a transfer of a copyrighted article.

The second category of comments concerned the definition of a copyrighted article. Section 1.861-18(c)(3) defines a copyrighted article as a copy of a computer program from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. Several commentators recommended the regulations be modified to say that the copy of the program need not be fixed in a tangible medium, and thus electronically transferred copies also constitute copyrighted articles.

Treasury and the IRS believe that the regulations clearly indicate that electronically transferred copies also constitute the transfer of a copyrighted article. Section 1.861-18(g)(2) of the final regulations continues to provide that the physical or electronic medium used to effectuate a transfer of a computer program shall not be taken into account. Also, the examples contained in the regulations, including paragraph (h), *Examples 2, 3, and 4*, specifically conclude that the electronic transfer of software can constitute the transfer of copyrighted articles.

One commentator suggested that the words “carrier medium” should be substituted for the words “the magnetic medium of a floppy disk” because computer programs may be distributed on a non-magnetic medium, such as a CD-ROM. This comment has been adopted in §1.861-18(c)(3) of the final regulations.

5. *Further Classification of a Copyright Right as a Sale or License.*

In classifying a copyright right as a sale or license, the proposed regulations look to whether, considering all the facts and circumstances, all substantial rights in a copyright right are transferred. Commentators raised a number of issues regarding the all substantial rights test, commenting on the effect of exclusivity, term of transfer, geographic area, and time and manner of payment.

Several commentators stated that exclusivity is the most important factor in determining whether all substantial rights have been transferred. They pointed out that two examples, *Examples 5 and 6*, discuss other factors, the term of the transfer and a transfer in a limited geographic area, in addition to exclusivity, and requested that the regulations explicitly state that exclusivity is the most important factor. One commentator suggested that the term of the transfer may not be relevant since the useful life of the program may be shorter than originally believed due to technological advances.

The final regulations do not incorporate these comments. The regulations were not intended to change the generally applicable “all substantial rights” test used in determining whether a transfer of an intangible, including copyright rights, is a sale of the intangible or a license of the intangible.

Another fact mentioned in the examples is the manner of payment. Several commentators stated that the term over which payments are made should be irrelevant in characterizing the transaction, and requested that this be made explicit. Although the regulations are not intended to depart from what is the generally applicable rule on this issue, this comment has been reflected in paragraph (h), *Example 5* of the final regulations, thus clarifying that the payment term is irrelevant on the facts of this example.

Several commentators pointed out that, in determining whether all substantial rights are transferred, the regulations state the principles of section 1222 and section 1235 shall apply. They seek clarification that section 1222, not section 1235, applies to transfers of copyrights, with section 1235 only applying to qualifying transfers of patents.

Although section 1235 by its terms only applies to patent transfers, the proposed regulations state that “the principles of sections 1222 and 1235” (emphasis added) shall apply. Treasury and the IRS believe that the all substantial rights test in the regulations under section 1235, although a safe harbor under that section, nevertheless reflects the all substantial rights test arising from case law generally, and is, therefore, an appropriate standard that may be applied. However, in applying the all substantial rights test to transactions in computer programs under these regulations, relevant case law, other than that specifically addressing section 1235 or section 1222, may also be applied, and the final regulations clarify this point.

6. *Further Classification of a Copyrighted Article as a Sale or Lease.*

a. *Lease Character for Copyrighted Articles.*

The proposed regulations treat a non-sale transfer of a copy of a computer program as a lease. Some commentators urged Treasury to reconsider its decision to adopt lease characterization for transactions that traditionally have been characterized as licenses. They submitted that the change creates confusion, is inconsistent with established commercial practice, and implies that all lease transactions involve tangible property. One commentator asked the IRS to clarify that the regulation is not intended to produce any differences in income tax consequences by treating a transfer of a program as a lease instead of a license.

These comments have not been adopted. Treasury and the IRS continue to believe that lease characterization is correct for non-sale transfers of copies of computer programs. Any income tax consequences from such characterization under these regulations will result from application of generally applicable tax law to the leasing transaction.

b. *Benefits and Burdens Test.*

In determining whether the transfer of a copyrighted article results in a sale, or instead as a lease generating rental income, the proposed regulations look to whether, based on the facts and circumstances, the benefits and burdens of ownership are

transferred. One commentator stated that this test is not helpful here, and proposed an economic substance test instead, focusing on the right to use a computer program as the economically valuable right. Under that standard, a copyrighted article would be considered sold if transferred with the right to use it indefinitely.

Other commentators, however, believed that the existing authorities applying the benefits and burdens test provide the correct analytical approach for distinguishing a sale from a lease of a copyrighted article.

The final regulations preserve the benefits and burdens test, and are not intended to change the generally applicable benefits and burdens test.

7. *Related Parties.*

The examples to the proposed regulations state that they assume the parties are unrelated. Several commentators requested that final regulations clarify the treatment of related parties under the regulations. They state that the regulations should apply to related and unrelated parties in the same way, and that Treasury should specify any particular concerns.

In response to these comments, the examples to the final regulations do not contain an assumption that the parties are unrelated. The regulations are intended to apply to related and unrelated parties in the same manner. The relationship between the parties does not affect the character of the transaction, with the exception of special rules regarding definition of the term “distribution to the public.” Of course, if the parties are related for purposes of section 482, that section may apply to determine the proper amount of consideration for the transfer.

8. *Services and Know-How.*

Some commentators suggested that final regulations clarify the relevancy of the distinction between the provision of services and the provision of know-how. This suggestion has not been incorporated in the final regulations. The purpose of the regulations is only to characterize transactions involving computer programs. Once the character of the transaction is determined under the regulations, the taxation of the income arising from the transaction is determined under other

Code sections. Thus, the relevance of the distinction between services and know-how must be determined under other Code sections. Compare sections 861(a)(3) and 862(a)(3), looking to place of performance in sourcing income from services, with sections 861(a)(4) and 862(a)(4), sourcing income derived from the transfer of certain know-how based on where the know-how is used. The distinction between services and know-how may also be relevant under income tax treaties. Compare Convention Between the United States of America and Japan for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, Article 8 (Business Profits) and Article 14 (Royalties).

Some commentators suggested the final regulations eliminate the requirement in paragraph (e) of the proposed regulations, requiring that know-how not be copyrightable as a prerequisite to being treated as know-how for purposes of this section. This comment has been adopted to eliminate any inference that only orally transmitted information could be classified as know-how. The final regulations, however, add two other requirements. Know-how is of the type covered by these regulations only if the information is information relating to computer programming techniques, is furnished under conditions preventing unauthorized disclosure, specifically contracted for between the parties, and is considered property subject to trade secret protection. Know-how is considered a property interest under applicable law, and only if the know-how is specifically contracted for between the parties. These additional requirements should help clarify the definition of know-how described in these regulations.

9. *Mixed Transactions.*

The proposed regulations state that if a transaction in a computer program consists of transactions in more than one category listed in §1.861-18(b)(1), the transactions, unless de minimis, will be treated as separate transactions, with the rules applied separately to each. Several commentators requested further guidance on how to treat transactions that include payments for updates, support, consulting, education, and training. They pointed out that in many cases, the extent to which such transactions or services will be re-

quired by the transferee are unknown at the time of the initial contract. They asked that regulations clarify the factors that will sustain an allocation where these various options are made available, or that Treasury consider bundling rules.

These comments have not been adopted. These regulations are limited to characterizing transactions relating to computer programs, and are not intended to provide rules for allocating income arising from mixed transactions. Mixed transactions occur in many circumstances outside of transactions involving computer programs. Whether income arising from a mixed transaction, involving computer programs or otherwise, must be allocated to its separate components under generally applicable principles of taxation, and the method by which such income is allocated to the transaction's components, must be determined under other Code sections.

10. *Shrink Wrap License.*

Several commentators stated that the reference to the term *shrink wrap license* in the proposed regulations should be deleted, because the reference can be misinterpreted as ascribing some legal significance to the term. They suggested a more general reference to a user agreement or a user license. In response to these comments, the final regulations now indicate in Example 1 that the term *shrink-wrap license* is merely illustrative. The regulations' analysis is based on the terms of the agreement between the parties, and on the nature and extent of the rights transferred, not the means of packaging or distributing the computer program. In particular, the use of the term *shrink-wrap license* in the proposed regulations was not intended to create an inference that the regulations apply only to mass-marketed software.

11. *Pre-Effective Date Transactions.*

The proposed regulations draw no inference for transactions prior to the regulations' effective date. One commentator recommended that the regulations permit taxpayers to elect retroactive application of the regulations. Another commentator requested a statement that a taxpayer's prior treatment of a transaction would be respected as long as it is reasonably supportable. Another commentator recom-

mended the IRS remedy double tax problems for transactions prior to the effective date.

The final regulations apply to transactions occurring pursuant to contracts entered into on or after the effective date of the regulations. A special transition rule permits taxpayers to elect to apply the regulations to transactions occurring pursuant to contracts entered into in taxable years ending on or after the date of publication of this document in the Federal Register. Taxpayers may also elect to apply this section to transactions occurring in taxable years ending on or after the date of publication of this document in the Federal Register, for contracts entered into before the date of publication of this document in the Federal Register, provided the taxpayer would not be required under this section to change its method of accounting, or the taxpayer would be required to change its method of accounting but the resulting section 481 adjustment would be zero.

With regard to double taxation, taxpayers who believe they are subject to double taxation may pursue competent authority relief.

12. *Accounting Method Changes.*

Commentators suggested that the IRS issue, simultaneously with the issuance of the final regulations, a revenue procedure permitting an automatic change of accounting to allow taxpayers to apply the principles of these regulations for purposes of accounting for prepaid income under software maintenance agreements. Different rules apply depending on whether the income from such agreements is considered to be derived from the sale of goods or the performance of services. Compare, §1.451-5 (sale of goods) and Rev. Proc. 71-21 (1971-2 CB 549) (performance of services).

In response to comments, the final regulations grant taxpayers consent to change their method of accounting if necessary to conform the classification of transactions with these regulations, where the taxpayer elects one of the transition rules in paragraph (i)(2) of the regulations. To obtain automatic consent to change a method of accounting, the regulations direct taxpayers to file Form 3115 with their returns and send a copy to the national office.

13. *Reverse Engineering and Decompilation.*

One commentator stated that the right to reverse engineer (or decompile) a computer program (i.e., the right to reconstruct the source code from the object code) should be irrelevant in classifying transactions in computer programs, and that references to that right should be eliminated from the examples.

This comment has not been adopted. The decompilation of a computer program can result in the creation of a derivative work. Under the regulations, the right to create a derivative work is a copyright right. Therefore, whether the transferee is prohibited from reverse engineering a computer program could be relevant in determining if a copyrighted article has been transferred.

14. *Effect of Practices Used to Control Piracy.*

One commentator suggested that certain practices used to control software piracy, such as a requirement that the transferee annually contact the transferor and pay an annual fee, be disregarded in determining whether a transaction results in a sale or lease of a computer program.

This comment has not been adopted. Such a transaction must be analyzed under the benefits and burdens test, taking into account all the facts and circumstances. Under that test, the requirement that the transferee contact the transferor and pay an annual fee might not result in lease characterization, if other significant benefits and burdens of ownership pass to the transferee.

15. *Definition of Computer.*

One commentator urged Treasury to adopt a flexible definition of the term *computer*. However, the final regulations do not define computer. The definition of software used in the regulations is based on the definition in the Copyright Act. The Copyright Act does not define the term *computer*.

16. *Comments (not otherwise addressed above) Regarding Specific Examples.*

a. *Paragraph (h), Examples 6 and 7.*

Commentators requested that, given the ease of reproduction, the distinction

between paragraph (h), *Examples 6* and *7* should be removed. This comment has not been adopted. Although computer programs can be easily reproduced, a fact which the regulations recognize, there is still an important commercial and legal distinction between persons who are granted the right to make copies of a program for distribution and persons who do not have that right.

b. *Example 6.*

In response to comments, the final regulations make clear that the party exercising reproduction rights can exercise that right indirectly by contracting out the reproduction function.

c. *Example 8.*

In response to a comment, *Example 8* has been clarified to indicate that the right to make back-up copies of the program, or the fact that a back-up copy of the program is transferred on a disk, is irrelevant to classification.

d. *Example 9.*

In response to a comment, paragraph (h), *Example 9* is clarified to indicate that the mechanics of copying a computer program are irrelevant.

e. *Example 10.*

Some commentators suggested that in the case of so-called enterprise licenses, the fact the transferee can use the program at multiple locations should not affect the character of the transaction as the sale of copyrighted articles. This comment has been adopted, and paragraph (h), *Example 10(ii)(C)* of the final regulations has been amended accordingly.

f. *Examples 12 and 13.*

Some commentators suggested adding examples to illustrate so-called software maintenance or subscription agreements. Paragraph (h), *Examples 12* and *13* of the proposed regulations, however, were intended to illustrate such agreements, and, in response to comments, these examples have been modified in the final regulations. Generally, the provision of an updated program pursuant to a maintenance agreement is intended to be treated as the transfer of a copyrighted article. How-

ever, this may not always be the case, and maintenance agreements must be analyzed in the same way as other transactions under the regulations.

g. *Example 15.*

A commentator suggested that the example's use of a derivative computer program adds complexity, and recommends the example be redrafted to purely illustrate services. This comment has been adopted and the example has been revised accordingly.

h. *Additional Examples.*

Commentators suggested additional examples. The final regulations add additional examples where clarification was believed necessary.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required.

It is hereby certified that the collection of information contained in these regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the rules of this section impact taxpayers who engage in international transactions in computer programs, and therefore the rules will impact very few small entities. Moreover, in those few instances where the rules of this section impact small entities, the economic impact of the collection of information on such small entities is not likely to be significant because it merely requires a copy of the Form 3115 to be filed with the National Office. Accordingly, a regulatory flexibility analysis is not required under the Regulatory Flexibility Act (5 U.S.C. chapter 6).

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 Anne Shelburne, of the Office of

Associate Chief Counsel (International), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Par. 2. Section 1.861-18 is added to read as follows:

§1.861-18 Classification of transactions involving computer programs.

(a) *General*—(1) *Scope.* This section provides rules for classifying transactions relating to computer programs for purposes of subchapter N of chapter 1 of the Internal Revenue Code, sections 367, 404A, 482, 551, 679, 1059A, chapter 3, chapter 5, sections 842 and 845 (to the extent involving a foreign person), and transfers to foreign trusts not covered by section 679.

(2) *Categories of transactions.* This section generally requires that such transactions be treated as being solely within one of four categories (described in paragraph (b)(1) of this section) and provides certain rules for categorizing such transactions. In the case of a transfer of a copyright right, this section provides rules for determining whether the transaction should be classified as either a sale or exchange, or a license generating royalty income. In the case of a transfer of a copyrighted article, this section provides rules for determining whether the transaction should be classified as either a sale or exchange, or a lease generating rental income.

(3) *Computer program.* For purposes of this section, a computer program is a set of statements or instructions to be used directly or indirectly in a computer in order to bring about a certain result. For purposes of this paragraph (a)(3), a computer program includes any media, user manuals, documentation, data base or similar item if the media, user manuals,

documentation, data base or similar item is incidental to the operation of the computer program.

(b) *Categories of transactions*—(1) *General*. Except as provided in paragraph (b)(2) of this section, a transaction involving the transfer of a computer program, or the provision of services or of know-how with respect to a computer program (collectively, a transfer of a computer program) is treated as being solely one of the following—

(i) A transfer of a copyright right in the computer program;

(ii) A transfer of a copy of the computer program (a copyrighted article);

(iii) The provision of services for the development or modification of the computer program; or

(iv) The provision of know-how relating to computer programming techniques.

(2) *Transactions consisting of more than one category*. Any transaction involving computer programs which consists of more than one of the transactions described in paragraph (b)(1) of this section shall be treated as separate transactions, with the appropriate provisions of this section being applied to each such transaction. However, any transaction that is *de minimis*, taking into account the overall transaction and the surrounding facts and circumstances, shall not be treated as a separate transaction, but as part of another transaction.

(c) *Transfers involving copyright rights and copyrighted articles*—(1) *Classification*—(i) *Transfers treated as transfers of copyright rights*. A transfer of a computer program is classified as a transfer of a copyright right if, as a result of the transaction, a person acquires any one or more of the rights described in paragraphs (c)(2)(i) through (iv) of this section. Whether the transaction is treated as being solely the transfer of a copyright right or is treated as separate transactions is determined pursuant to paragraph (b)(1) and (b)(2) of this section. For example, if a person receives a disk containing a copy of a computer program which enables it to exercise, in relation to that program, a non-*de minimis* right described in paragraphs (c)(2)(i) through (iv) of this section (and the transaction does not involve, or involves only a *de minimis* provision of services as described in paragraph (d) of this section or

of know-how as described in paragraph (e) of this section), then, under paragraph (b)(2) of this section, the transfer is classified solely as a transfer of a copyright right.

(ii) *Transfers treated solely as transfers of copyrighted articles*. If a person acquires a copy of a computer program but does not acquire any of the rights described in paragraphs (c)(2)(i) through (iv) of this section (or only acquires a *de minimis* grant of such rights), and the transaction does not involve, or involves only a *de minimis*, provision of services as described in paragraph (d) of this section or of know-how as described in paragraph (e) of this section, the transfer of the copy of the computer program is classified solely as a transfer of a copyrighted article.

(2) *Copyright rights*. The copyright rights referred to in paragraph (c)(1) of this section are as follows—

(i) The right to make copies of the computer program for purposes of distribution to the public by sale or other transfer of ownership, or by rental, lease or lending;

(ii) The right to prepare derivative computer programs based upon the copyrighted computer program;

(iii) The right to make a public performance of the computer program; or

(iv) The right to publicly display the computer program.

(3) *Copyrighted article*. A copyrighted article includes a copy of a computer program from which the work can be perceived, reproduced, or otherwise communicated, either directly or with the aid of a machine or device. The copy of the program may be fixed in the magnetic medium of a floppy disk, or in the main memory or hard drive of a computer, or in any other medium.

(d) *Provision of services*. The determination of whether a transaction involving a newly developed or modified computer program is treated as either the provision of services or another transaction described in paragraph (b)(1) of this section is based on all the facts and circumstances of the transaction, including, as appropriate, the intent of the parties (as evidenced by their agreement and conduct) as to which party is to own the copyright rights in the computer program and how the risks of loss are allocated between the parties.

(e) *Provision of know-how*. The provision of information with respect to a computer program will be treated as the provision of know-how for purposes of this section only if the information is—

(1) Information relating to computer programming techniques;

(2) Furnished under conditions preventing unauthorized disclosure, specifically contracted for between the parties; and

(3) Considered property subject to trade secret protection.

(f) *Further classification of transfers involving copyright rights and copyrighted articles*—(1) *Transfers of copyright rights*. The determination of whether a transfer of a copyright right is a sale or exchange of property is made on the basis of whether, taking into account all facts and circumstances, there has been a transfer of all substantial rights in the copyright. A transaction that does not constitute a sale or exchange because not all substantial rights have been transferred will be classified as a license generating royalty income. For this purpose, the principles of sections 1222 and 1235 may be applied. Income derived from the sale or exchange of a copyright right will be sourced under section 865(a), (c), (d), (e), or (h), as appropriate. Income derived from the licensing of a copyright right will be sourced under section 861(a)(4) or 862(a)(4), as appropriate.

(2) *Transfers of copyrighted articles*. The determination of whether a transfer of a copyrighted article is a sale or exchange is made on the basis of whether, taking into account all facts and circumstances, the benefits and burdens of ownership have been transferred. A transaction that does not constitute a sale or exchange because insufficient benefits and burdens of ownership of the copyrighted article have been transferred, such that a person other than the transferee is properly treated as the owner of the copyrighted article, will be classified as a lease generating rental income. Income from transactions that are classified as sales or exchanges of copyrighted articles will be sourced under sections 861(a)(6), 862(a)(6), 863, 865(a), (b), (c), or (e), as appropriate. Income derived from the leasing of a copyrighted article will be sourced under section 861(a)(4) or section 862(a)(4), as appropriate.

(3) *Special circumstances of computer programs.* In connection with determinations under this paragraph (f), consideration must be given as appropriate to the special characteristics of computer programs in transactions that take advantage of these characteristics (such as the ability to make perfect copies at minimal cost). For example, a transaction in which a person acquires a copy of a computer program on disk subject to a requirement that the disk be destroyed after a specified period is generally the equivalent of a transaction subject to a requirement that the disk be returned after such period. Similarly, a transaction in which the program deactivates itself after a specified period is generally the equivalent of returning the copy.

(g) *Rules of operation—(1) Term applied to transaction by parties.* Neither the form adopted by the parties to a transaction, nor the classification of the transaction under copyright law, shall be determinative. Therefore, for example, if there is a transfer of a computer program on a single disk for a one-time payment with restrictions on transfer and reverse engineering, which the parties characterize as a license (including, but not limited to, agreements commonly referred to as shrink-wrap licenses), application of the rules of paragraphs (c) and (f) of this section may nevertheless result in the transaction being classified as the sale of a copyrighted article.

(2) *Means of transfer not to be taken into account.* The rules of this section shall be applied irrespective of the physical or electronic or other medium used to effectuate a transfer of a computer program.

(3) *To the public—(i) In general.* For purposes of paragraph (c)(2)(i) of this section, a transferee of a computer program shall not be considered to have the right to distribute copies of the program to the public if it is permitted to distribute copies of the software to only either a related person, or to identified persons who may be identified by either name or by legal relationship to the original transferee. For purposes of this subparagraph, a related person is a person who bears a relationship to the transferee specified in section 267(b)(3), (10), (11), or (12), or section 707(b)(1)(B). In applying section 267(b), 267(f), 707(b)(1)(B), or 1563(a), “10 percent” shall be substituted for “50 percent.”

(ii) *Use by individuals.* The number of employees of a transferee of a computer program who are permitted to use the program in connection with their employment is not relevant for purposes of this paragraph (g)(3). In addition, the number of individuals with a contractual agreement to provide services to the transferee of a computer program who are permitted to use the program in connection with the performance of those services is not relevant for purposes of this paragraph (g)(3).

(h) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. (i) *Facts.* Corp A, a U.S. corporation, owns the copyright in a computer program, Program X. It copies Program X onto disks. The disks are placed in boxes covered with a wrapper on which is printed what is generally referred to as a shrink-wrap license. The license is stated to be perpetual. Under the license no reverse engineering, decompilation, or disassembly of the computer program is permitted. The transferee receives, first, the right to use the program on two of its own computers (for example, a laptop and a desktop) provided that only one copy is in use at any one time, and, second, the right to make one copy of the program on each machine as an essential step in the utilization of the program. The transferee is permitted by the shrink-wrap license to sell the copy so long as it destroys any other copies it has made and imposes the same terms and conditions of the license on the purchaser of its copy. These disks are made available for sale to the general public in Country Z. In return for valuable consideration, P, a Country Z resident, receives one such disk.

(ii) *Analysis.* (A) Under paragraph (g)(1) of this section, the label license is not determinative. None of the copyright rights described in paragraph (c)(2) of this section have been transferred in this transaction. P has received a copy of the program, however, and, therefore, under paragraph (c)(1)(ii) of this section, P has acquired solely a copyrighted article.

(B) Taking into account all of the facts and circumstances, P is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a sale of a copyrighted article rather than the grant of a lease.

Example 2. (i) *Facts.* The facts are the same as those in Example 1, except that instead of selling disks, Corp A, the U.S. corporation, decides to make Program X available, for a fee, on a World Wide Web home page on the Internet. P, the Country Z resident, in return for payment made to Corp A, downloads Program X (via modem) onto the hard drive of his computer. As part of the electronic communication, P signifies his assent to a license agreement with terms identical to those in Example 1, except that in this case P may make a back-up copy of the program on to a disk.

(ii) *Analysis.* (A) None of the copyright rights described in paragraph (c)(2) of this section have passed to P. Although P did not buy a physical copy of the disk with the program on it, paragraph (g)(2) of this section provides that the means of transfer-

ring the program is irrelevant. Therefore, P has acquired a copyrighted article.

(B) As in Example 1, P is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a sale of a copyrighted article rather than the grant of a lease.

Example 3. (i) *Facts.* The facts are the same as those in Example 1, except that Corp A only allows P, the Country Z resident, to use Program X for one week. At the end of that week, P must return the disk with Program X on it to Corp A. P must also destroy any copies made of Program X. If P wishes to use Program X for a further period he must enter into a new agreement to use the program for an additional charge.

(ii) *Analysis.* (A) Under paragraph (c)(2) of this section, P has received no copyright rights. Because P has received a copy of the program under paragraph (c)(1)(ii) of this section, he has, therefore, received a copyrighted article.

(B) Taking into account all of the facts and circumstances, P is not properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a lease of a copyrighted article rather than a sale. Taking into account the special characteristics of computer programs as provided in paragraph (f)(3) of this section, the result would be the same if P were required to destroy the disk at the end of the one week period instead of returning it since Corp A can make additional copies of the program at minimal cost.

Example 4. (i) *Facts.* The facts are the same as those in Example 2, where P, the Country Z resident, receives Program X from Corp A's home page on the Internet, except that P may only use Program X for a period of one week at the end of which an electronic lock is activated and the program can no longer be accessed. Thereafter, if P wishes to use Program X, it must return to the home page and pay Corp A to send an electronic key to reactivate the program for another week.

(ii) *Analysis.* (A) As in Example 3, under paragraph (c)(2) of this section, P has not received any copyright rights. P has received a copy of the program, and under paragraph (g)(2) of this section, the means of transmission is irrelevant. P has, therefore, under paragraph (c)(1)(ii) of this section, received a copyrighted article.

(B) As in Example 3, P is not properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been a lease of a copyrighted article rather than a sale. While P does retain Program X on its computer at the end of the one week period, as a legal matter P no longer has the right to use the program (without further payment) and, indeed, cannot use the program without the electronic key. Functionally, Program X is no longer on the hard drive of P's computer. Instead, the hard drive contains only a series of numbers which no longer perform the function of Program X. Although in Example 3, P was required to physically return the disk, taking into account the special characteristics of computer programs as provided in paragraph (f)(3) of this section, the result in this Example 4 is the same as in Example 3.

Example 5. (i) *Facts.* Corp A, a U.S. corporation, transfers a disk containing Program X to Corp B, a Country Z corporation, and grants Corp B an exclusive license for the remaining term of the copy-

right to copy and distribute an unlimited number of copies of Program X in the geographic area of Country Z, prepare derivative works based upon Program X, make public performances of Program X, and publicly display Program X. Corp B will pay Corp A a royalty of \$y a year for three years, which is the expected period during which Program X will have commercially exploitable value.

(ii) *Analysis.* (A) Although Corp A has transferred a disk with a copy of Program X on it to Corp B, under paragraph (c)(1)(i) of this section because this transfer is accompanied by a copyright right identified in paragraph (c)(2)(i) of this section, this transaction is a transfer solely of copyright rights, not of copyrighted articles. For purposes of paragraph (b)(2) of this section, the disk containing a copy of Program X is a *de minimis* component of the transaction.

(B) Applying the all substantial rights test under paragraph (f)(1) of this section, Corp A will be treated as having sold copyright rights to Corp B. Corp B has acquired all of the copyright rights in Program X, has received the right to use them exclusively within Country Z, and has received the rights for the remaining life of the copyright in Program X. The fact the payments cease before the copyright term expires is not controlling. Under paragraph (g)(1) of this section, the fact that the agreement is labelled a license is not controlling (nor is the fact that Corp A receives a sum labelled a royalty). (The result in this case would be the same if the copy of Program X to be used for the purposes of reproduction were transmitted electronically to Corp B, as a result of the application of the rule of paragraph (g)(2) of this section.)

Example 6. (i) *Facts.* Corp A, a U.S. corporation, transfers a disk containing Program X to Corp B, a Country Z corporation, and grants Corp B the non exclusive right to reproduce (either directly or by contracting with either Corp A or another person to do so) and distribute for sale to the public an unlimited number of disks at its factory in Country Z in return for a payment related to the number of disks copied and sold. The term of the agreement is two years, which is less than the remaining life of the copyright.

(ii) *Analysis.* (A) As in *Example 5*, the transfer of the disk containing the copy of the program does not constitute the transfer of a copyrighted article under paragraph (c)(1) of this section because Corp B has also acquired a copyright right under paragraph (c)(2)(i) of this section, the right to reproduce and distribute to the public. For purposes of paragraph (b)(2) of this section, the disk containing Program X is a *de minimis* component of the transaction.

(B) Taking into account all of the facts and circumstances, there has been a license of Program X to Corp B, and the payments made by Corp B are royalties. Under paragraph (f)(1) of this section, there has not been a transfer of all substantial rights in the copyright to Program X because Corp A has the right to enter into other licenses with respect to the copyright of Program X, including licenses in Country Z (or even to sell that copyright, subject to Corp B's interest). Corp B has acquired no right itself to license the copyright rights in Program X. Finally, the term of the license is for less than the remaining life of the copyright in Program X.

Example 7. (i) *Facts.* Corp C, a distributor in Country Z, enters into an agreement with Corp A, a

U.S. corporation, to purchase as many copies of Program X on disk as it may from time-to-time request. Corp C will then sell these disks to retailers. The disks are shipped in boxes covered by shrink-wrap licenses (identical to the license described in *Example 1*).

(ii) *Analysis.* (A) Corp C has not acquired any copyright rights under paragraph (c)(2) of this section with respect to Program X. It has acquired individual copies of Program X, which it may sell to others. The use of the term license is not dispositive under paragraph (g)(1) of this section. Under paragraph (c)(1)(ii) of this section, Corp C has acquired copyrighted articles.

(B) Taking into account all of the facts and circumstances, Corp C is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been a sale of copyrighted articles.

Example 8. (i) *Facts.* Corp A, a U.S. corporation, transfers a disk containing Program X to Corp D, a foreign corporation engaged in the manufacture and sale of personal computers in Country Z. Corp A grants Corp D the non-exclusive right to copy Program X onto the hard drive of an unlimited number of computers, which Corp D manufactures, and to distribute those copies (on the hard drive) to the public. The term of the agreement is two years, which is less than the remaining life of the copyright in Program X. Corp D pays Corp A an amount based on the number of copies of Program X it loads on to computers.

(ii) *Analysis.* The analysis is the same as in *Example 6*. Under paragraph (c)(2)(i) of this section, Corp D has acquired a copyright right enabling it to exploit Program X by copying it on to the hard drives of the computers that it manufactures and then sells. For purposes of paragraph (b)(2) of this section, the disk containing Program X is a *de minimis* component of the transaction. Taking into account all of the facts and circumstances, Corp D has not, however, acquired all substantial rights in the copyright to Program X (for example, the term of the agreement is less than the remaining life of the copyright). Under paragraph (f)(1) of this section, this transaction is, therefore, a license of Program X to Corp D rather than a sale and the payments made by Corp D are royalties. (The result would be the same if Corp D included with the computers it sells an archival copy of Program X on a floppy disk.)

Example 9. (i) *Facts.* The facts are the same as in *Example 8*, except that Corp D, the Country Z corporation, receives physical disks. The disks are shipped in boxes covered by shrink-wrap licenses (identical to the licenses described in *Example 1*). The terms of these licenses do not permit Corp D to make additional copies of Program X. Corp D uses each individual disk only once to load a single copy of Program X onto each separate computer. Corp D transfers the disk with the computer when it is sold.

(ii) *Analysis.* (A) As in *Example 7* (unlike *Example 8*) no copyright right identified in paragraph (c)(2) of this section has been transferred. Corp D acquires the disks without the right to reproduce and distribute publicly further copies of Program X. This is therefore the transfer of copyrighted articles under paragraph (c)(1)(ii) of this section.

(B) Taking into account all of the facts and circumstances, Corp D is properly treated as the owner of copyrighted articles. Therefore, under paragraph

(f)(2) of this section, the transaction is classified as the sale of a copyrighted article. (The result would be the same if Corp D used a single physical disk to copy Program X onto each computer, and transferred an unopened box containing Program X with each computer, if Corp D were not permitted to copy Program X onto more computers than the number of individual copies purchased.)

Example 10. (i) *Facts.* Corp A, a U.S. corporation, transfers a disk containing Program X to Corp E, a Country Z corporation, and grants Corp E the right to load Program X onto 50 individual workstations for use only by Corp E employees at one location in return for a one-time per-user fee (generally referred to as a site license or enterprise license). If additional workstations are subsequently introduced, Program X may be loaded onto those machines for additional one-time per-user fees. The license which grants the rights to operate Program X on 50 workstations also prohibits Corp E from selling the disk (or any of the 50 copies) or reverse engineering the program. The term of the license is stated to be perpetual.

(ii) *Analysis.* (A) The grant of a right to copy, unaccompanied by the right to distribute those copies to the public, is not the transfer of a copyright right under paragraph (c)(2) of this section. Therefore, under paragraph (c)(1)(ii) of this section, this transaction is a transfer of copyrighted articles (50 copies of Program X).

(B) Taking into account all of the facts and circumstances, P is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been a sale of copyrighted articles rather than the grant of a lease. Notwithstanding the restriction on sale, other factors such as, for example, the risk of loss and the right to use the copies in perpetuity outweigh, in this case, the restrictions placed on the right of alienation.

(C) The result would be the same if Corp E were permitted to copy Program X onto an unlimited number of workstations used by employees of either Corp E or corporations that had a relationship to Corp E specified in paragraph (g)(3) of this section.

Example 11. (i) *Facts.* The facts are the same as in *Example 10*, except that Corp E, the Country Z corporation, acquires the right to make Program X available to workstation users who are Corp E employees by way of a local area network (LAN). The number of users that can use Program X on the LAN at any one time is limited to 50. Corp E pays a one-time fee for the right to have up to 50 employees use the program at the same time.

(ii) *Analysis.* Under paragraph (g)(2) of this section the mode of utilization is irrelevant. Therefore, as in *Example 10*, under paragraph (c)(2) of this section, no copyright right has been transferred, and, thus, under paragraph (c)(1)(ii) of this section, this transaction will be classified as the transfer of a copyrighted article. Under the benefits and burdens test of paragraph (f)(2) of this section, this transaction is a sale of copyrighted articles. The result would be the same if an unlimited number of Corp E employees were permitted to use Program X on the LAN or if Corp E were permitted to copy Program X onto LANs maintained by corporations that had a relationship to Corp E specified in paragraph (g)(3) of this section.

Example 12. (i) *Facts.* The facts are the same as in *Example 11*, except that Corp E pays a monthly fee to Corp A, the U.S. corporation, calculated with

reference to the permitted maximum number of users (which can be changed) and the computing power of Corp E's server. In return for this monthly fee, Corp E receives the right to receive upgrades of Program X when they become available. The agreement may be terminated by either party at the end of any month. When the disk containing the upgrade is received, Corp E must return the disk containing the earlier version of Program X to Corp A. If the contract is terminated, Corp E must delete (or otherwise destroy) all copies made of the current version of Program X. The agreement also requires Corp A to provide technical support to Corp E but the agreement does not allocate the monthly fee between the right to receive upgrades of Program X and the technical support services. The amount of technical support that Corp A will provide to Corp E is not foreseeable at the time the contract is entered into but is expected to be *de minimis*. The agreement specifically provides that Corp E has not thereby been granted an option to purchase Program X.

(ii) *Analysis.* (A) Corp E has received no copyright rights under paragraph (c)(2) of this section. Corp A has not provided any services described in paragraph (d) of this section. Based on all the facts and circumstances of the transaction, Corp A has provided *de minimis* technical services to Corp E. Therefore, under paragraph (c)(1)(ii) of this section, the transaction is a transfer of a copyrighted article.

(B) Taking into account all facts and circumstances, under the benefits and burdens test Corp E is not properly treated as the owner of the copyrighted article. Corp E does not receive the right to use Program X in perpetuity, but only for so long as it continues to make payments. Corp E does not have the right to purchase Program X on advantageous (or, indeed, any) terms once a certain amount of money has been paid to Corp A or a certain period of time has elapsed (which might indicate a sale). Once the agreement is terminated, Corp E will no longer possess any copies of Program X, current or superseded. Therefore under paragraph (f)(2) of this section there has been a lease of a copyrighted article.

Example 13. (i) *Facts.* The facts are the same as in *Example 12*, except that, while Corp E must return copies of Program X as new upgrades are received, if the agreement terminates, Corp E may keep the latest version of Program X (although Corp E is still prohibited from selling or otherwise transferring any copy of Program X).

(ii) *Analysis.* For the reasons stated in *Example 10*, paragraph (ii)(B), the transfer of the program will be treated as a sale of a copyrighted article rather than as a lease.

Example 14. (i) *Facts.* Corp G, a Country Z corporation, enters into a contract with Corp A, a U.S. corporation, for Corp A to modify Program X so that it can be used at Corp G's facility in Country Z. Under the contract, Corp G is to acquire one copy of the program on a disk and the right to use the program on 5,000 workstations. The contract requires Corp A to rewrite elements of Program X so that it will conform to Country Z accounting standards and states that Corp A retains all copyright rights in the modified Program X. The agreement between Corp A and Corp G is otherwise identical as to rights and payment terms as the agreement described in *Example 10*.

(ii) *Analysis.* (A) As in *Example 10*, no copyright rights are being transferred under paragraph

(c)(2) of this section. In addition, since no copyright rights are being transferred to Corp G, this transaction does not involve the provision of services by Corp A under paragraph (d) of this section. This transaction will be classified, therefore, as a transfer of copyrighted articles under paragraph (c)(1)(ii) of this section.

(B) Taking into account all facts and circumstances, Corp G is properly treated as the owner of copyrighted articles. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

Example 15. (i) *Facts.* Corp H, a Country Z corporation, enters into a license agreement for a new computer program. Program Q is to be written by Corp A, a U.S. corporation. Corp A and Corp H agree that Corp A is writing Program Q for Corp H and that, when Program Q is completed, the copyright in Program Q will belong to Corp H. Corp H gives instructions to Corp A programmers regarding program specifications. Corp H agrees to pay Corp A a fixed monthly sum during development of the program. If Corp H is dissatisfied with the development of the program, it may cancel the contract at the end of any month. In the event of termination, Corp A will retain all payments, while any procedures, techniques or copyrightable interests will be the property of Corp H. All of the payments are labelled royalties. There is no provision in the agreement for any continuing relationship between Corp A and Corp H, such as the furnishing of updates of the program, after completion of the modification work.

(ii) *Analysis.* Taking into account all of the facts and circumstances, Corp A is treated as providing services to Corp H. Under paragraph (d) of this section, Corp A is treated as providing services to Corp H because Corp H bears all of the risks of loss associated with the development of Program Q and is the owner of all copyright rights in Program Q. Under paragraph (g)(1) of this section, the fact that the agreement is labelled a license is not controlling (nor is the fact that Corp A receives a sum labelled a royalty).

Example 16. (i) *Facts.* Corp A, a U.S. corporation, and Corp I, a Country Z corporation, agree that a development engineer employed by Corp A will travel to Country Z to provide know-how relating to certain techniques not generally known to computer programmers, which will enable Corp I to more efficiently create computer programs. These techniques represent the product of experience gained by Corp A from working on many computer programming projects, and are furnished to Corp I under nondisclosure conditions. Such information is property subject to trade secret protection.

(ii) *Analysis.* This transaction contains the elements of know-how specified in paragraph (e) of this section. Therefore, this transaction will be treated as the provision of know-how.

Example 17. (i) *Facts.* Corp A, a U.S. corporation, transfers a disk containing Program Y to Corp E, a Country Z corporation, in exchange for a single fixed payment. Program Y is a computer program development program, which is used to create other computer programs, consisting of several components, including libraries of reusable software components that serve as general building blocks in new software applications. No element of these libraries is a significant component of any overall new program. Because a computer program created with the

use of Program Y will not operate unless the libraries are also present, the license agreement between Corp A and Corp E grants Corp E the right to distribute copies of the libraries with any program developed using Program Y. The license agreement is otherwise identical to the license agreement in *Example 1*.

(ii) *Analysis.* (A) No non-*de minimis* copyright rights described in paragraph (c)(2) of this section have passed to Corp E. For purposes of paragraph (b)(2) of this section, the right to distribute the libraries in conjunction with the programs created using Program Y is a *de minimis* component of the transaction. Because Corp E has received a copy of the program under paragraph (c)(1)(ii) of this section, it has received a copyrighted article.

(B) Taking into account all the facts and circumstances, Corp E is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

Example 18. (i) *Facts.* (A) Corp A, a U.S. corporation, transfers a disk containing Program X to Corp E, a country Z Corporation. The disk contains both the object code and the source code to Program X and the license agreement grants Corp E the right to—

(1) Modify the source code in order to correct minor errors and make minor adaptations to Program X so it will function on Corp E's computer; and

(2) Recompile the modified source code.

(B) The license does not grant Corp E the right to distribute the modified Program X to the public. The license is otherwise identical to the license agreement in *Example 1*.

(ii) *Analysis.* (A) No non-*de minimis* copyright rights described in paragraph (c)(2) of this section have passed to Corp E. For purposes of paragraph (b)(2) of this section, the right to modify the source code and recompile the source code in order to create new code to correct minor errors and make minor adaptations is a *de minimis* component of the transaction. Because Corp E has received a copy of the program under paragraph (c)(1)(ii) of this section, it has received a copyrighted article.

(B) Taking into account all the facts and circumstances, Corp E is properly treated as the owner of a copyrighted article. Therefore, under paragraph (f)(2) of this section, there has been the sale of a copyrighted article rather than the grant of a lease.

(i) *Effective date*—(1) *General.* This section applies to transactions occurring pursuant to contracts entered into on or after December 1, 1998.

(2) *Elective transition rules*—(i) *Contracts entered into in taxable years ending on or after October 2, 1998.* A taxpayer may elect to apply this section to transactions occurring pursuant to contracts entered into in taxable years ending on or after October 2, 1998. A taxpayer that makes an election under this paragraph (i)(2)(i) must apply this section to all contracts entered into in taxable years ending on or after October 2, 1998.

(ii) *Contracts entered into before October 2, 1998.* A taxpayer may elect to apply this section to transactions occurring in taxable years ending on or after October 2, 1998, pursuant to contracts entered into before October 2, 1998, provided the taxpayer would not be required under this section to change its method of accounting as a result of such election, or the taxpayer would be required to change its method of accounting but the resulting section 481(a) adjustment would be zero. A taxpayer that makes an election under this paragraph (i)(2)(ii) must apply this section to all transactions occurring in taxable years ending on or after October 2, 1998, pursuant to contracts entered into before October 2, 1998.

(3) *Manner of making election.* Taxpayers may elect, under paragraph (i)(2)(i) or (i)(2)(ii) of this section, to apply this section, by treating the transactions in accordance with these regulations on their original tax return.

(4) *Examples.* The following examples illustrate application of the transition rule of paragraph (i)(2)(ii) of this section:

Example 1. Corp A develops computer programs for sale to third parties. Corp A uses an overall accrual method of accounting and files its tax return on a calendar-year basis. In year 1, Corp A enters into a contract to deliver a computer program in that year, and to provide updates for each of the following four years. Under the contract, the computer program and the updates are priced separately, and Corp A is entitled to receive payments for the computer program and each of the updates upon delivery. Assume Corp A properly accounts for the contract as a contract for the provision of services. Corp A properly includes the payments under the contract in gross income in the taxable year the payments are received and the computer program or updates are delivered. Corp A properly deducts the cost of developing the computer program and updates when the costs are incurred. Year 3 includes October 2, 1998. Assume under the rules of this section, the provision of updates would properly be accounted for as the transfer of copyrighted articles. If Corp A made an election under paragraph (i)(2)(ii) of this section, Corp A would not be required to change its method of accounting for income under the contract as a result of the election. Corp A would also not be required to change its method of accounting for the cost of developing the computer program and the updates under the contract as a result of the election. Therefore, under paragraph (i)(2)(ii) of this section, Corp A may elect to apply the provisions of this section to the updates provided in years 3, 4, and 5, because Corp A is not required to change from its accrual method of accounting for the contract as a result of the election.

Example 2. Corp A develops computer programs for sale to third parties. Corp A uses an overall accrual method of accounting and files its tax return on

a calendar-year basis. In year 1, Corp A enters into a contract to deliver a computer program and to provide one update the following year. Under the contract, the computer program and the update are priced separately, and Corp A is entitled to receive payment for the computer program and the update upon delivery of the computer program. Assume Corp A properly accounts for the contract as a contract for the provision of services. Corp A properly includes the portion of the payment relating to the computer program in gross income in year 1, the taxable year the payment is received and the program delivered. Corp A properly includes the portion of the payment relating to the update in gross income in year 2, the taxable year the update is provided, under Rev. Proc. 71-21, 1971-2 CB 549 (see §601.601 (d)(2) of this chapter). Corp A properly deducts the cost of developing the computer program and update when the costs are incurred. Year 2 includes October 2, 1998. Assume under the rules of this section, provision of the update would properly be accounted for as the transfer of a copyrighted article. If Corp A made an election under paragraph (i)(2)(ii) of this section, Corp A would be required to change its method of accounting for deferring income under its contract as a result of the election. However, the section 481(a) adjustment would be zero because the portion of the payment relating to the update would be includible in gross income in year 2, the taxable year the update is provided, under both Rev. Proc. 71-21 and §1.451-5. Corp A would not be required to change its method of accounting for the cost of developing the computer program and the update under the contract as a result of the election. Therefore, under paragraph (i)(2)(ii) of this section, Corp A may elect to apply the provisions of this section to the update in year 2, because the section 481(a) adjustment resulting from the change in method of accounting for deferring advance payments under the contract is zero, and because Corp A is not required to change from its accrual method of accounting for the cost of developing the computer program and updates under the contract as a result of the election.

Example 3. Assume the same facts as in *Example 1* except that Corp A is entitled to receive payments for the computer program and each of the updates 30 days after delivery. Corp A properly includes the amounts due under the contract in gross income in the taxable year the computer program or updates are provided. Assume that Corp A properly uses the nonaccrual-experience method described in section 448(d)(5) and §1.448-2T to account for income on its contracts. If Corp A made an election under paragraph (i)(2)(ii) of this section, Corp A would be required to change from the nonaccrual-experience method for income as a result of the election, because the method is only available with respect to amounts to be received for the performance of services. Therefore, Corp A may not elect to apply the provisions of this section to the updates provided in years 3, 4, and 5, under paragraph (i)(2)(ii) of this section, because Corp A would be required to change from the nonaccrual-experience method of accounting for income on the contract as a result of the election.

(j) *Change in method of accounting required by this section—(1) Consent.* A taxpayer is granted consent to change its

method of accounting for contracts involving computer programs, to conform with the classification prescribed in this section. The consent is granted for contracts entered into on or after December 1, 1998, or in the case of a taxpayer making an election under paragraph (i)(2)(i) of this section, the consent is granted for contracts entered into in taxable years ending on or after October 2, 1998. In addition, a taxpayer that makes an election under paragraph (i)(2)(ii) of this section is granted consent to change its method of accounting for any contract with transactions subject to the election, if the taxpayer is required to change its method of accounting as a result of the election.

(2) *Year of change.* The year of change is the taxable year that includes December 1, 1998, or in the case of a taxpayer making an election under paragraph (i)(2)(i) or (i)(2)(ii) of this section, the taxable year that includes October 2, 1998.

(k) *Time and manner of making change in method of accounting—(1) General.* A taxpayer changing its method of accounting in accordance with this section must file a Form 3115, Application for Change in Method of Accounting, in duplicate. The taxpayer must type or print the following statement at the top of page 1 of the Form 3115: “FILED UNDER TREASURY REGULATION §1.861-18.” The original Form 3115 must be attached to the taxpayers original return for the year of change. A copy of the Form 3115 must be filed with the National Office no later than when the original Form 3115 is filed for the year of change.

(2) *Copy of Form 3115.* The copy required by this paragraph (k)(1) to be sent to the national office should be sent to the Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, P.O. Box 7604, Benjamin Franklin Station, Washington, DC 20044 (or in the case of a designated private delivery service: Commissioner of Internal Revenue, Attention: CC:DOM:IT&A, 1111 Constitution Avenue, NW, Washington, DC 20224).

(3) *Effect of consent and Internal Revenue Service review.* A change in method of accounting granted under this section is subject to review by the district director and the national office and may be modified or revoked in accordance with the provisions of Rev. Proc. 97-37 (1997-33 IRB 18) (or its successors) (see §601.601(d)(2) of this chapter).

PART 602—OMB CONTROL
 NUMBERS UNDER THE
 PAPERWORK REDUCTION ACT

Par. 3. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 4. In §602.101, paragraph (c) is amended by adding an entry to the table in numerical order to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
	* * * * *
1.861-18	1545-1594
	* * * * *

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

Approved April 1, 1998.

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

(Filed by the Office of the Federal Register on September 30, 1998, 8:45 a.m., and published in the issue of the Federal Register for October 2, 1998, 63 F.R. 52971)

Part IV. Items of General Interest

Notice of Proposed Rulemaking

Substantiation of Business Expenses—Use of Mileage Rates to Substantiate Automobile Expenses

REG-122488-97

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking.

SUMMARY: This document contains proposed regulations relating to the use of mileage rates to substantiate automobile business expenses. The regulations affect taxpayers who deduct expenses, and payors who make payments and employees who receive payments under reimbursement or other expense allowance arrangements, for the business use of an automobile.

DATES: Written or electronically generated comments and requests for a public hearing must be received by December 30, 1998.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, contact Edwin B. Cleverdon or Donna M. Crisalli, (202) 622-4920 (not a toll-free number).

ADDRESSES: Send submissions to CC:DOM:CORP:R (REG-122488-97), 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-122488-97), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC.

Additionally, taxpayers may submit comments electronically via INTERNET by selecting the "Tax Regs" option on the IRS INTERNET site at: http://www.irs.ustreas.gov/prod/tax_regs/comments.html.

SUPPLEMENTARY INFORMATION

Background and Explanation of Provisions

Section 274(d) provides that a taxpayer

is not allowed a deduction or credit for certain expenses unless the expense is substantiated. These substantiation requirements apply to the expenses of use of any listed property (defined in section 280F(d)(4)), which includes any passenger automobile and any other property used as a means of transportation. The Secretary may issue regulations that provide that some or all of the substantiation requirements will not apply to expenses that do not exceed a prescribed amount.

Section 1.274-5T(b)(6) sets forth the elements of an expenditure or use, i.e., the amount, time, and business purpose, that are required to be substantiated with respect to listed property. Section 1.274(d)-1 provides, in part, that the Commissioner may prescribe rules under which mileage allowances reimbursing ordinary and necessary expenses of local travel and transportation while traveling away from home will satisfy the substantiation requirements of §1.274-5T(c), and the requirements of an adequate accounting to the employer for purposes of §1.274-5T(f)(4). However, §1.274(d)-1(a)(3) provides that such mileage allowances are available only to the owner of a vehicle.

Proposed §1.274-5(g) applies these substantiation rules to mileage allowances for business use of an automobile without the limitation in §1.274(d)-1(a)(3) that a mileage allowance is available only to the owner of a vehicle. Proposed §1.274-5(j)(1) continues to authorize the Commissioner to establish a method for computing meal expenses while traveling away from home (see current §1.274-5T(j)), while §1.274-5(j)(2) authorizes the Commissioner to establish a method under which a taxpayer may use mileage rates to determine the amount of the ordinary and necessary business expenses of using an automobile for local transportation and transportation to, from, and at the destination while traveling away from home in lieu of substantiating the actual costs. The mileage rate method may include appropriate limitations and conditions in order to reflect more accurately automobile expenses over the entire period of usage. The taxpayer would not, however, be relieved of substantiating the amount of each business use (i.e., the

business mileage) and the time and business purpose of each use. See Rev. Proc. 97-59 (1997-52 I.R.B. 24), for rules for using the mileage rate method. This proposed §1.274-5(g), (j), and (m) supplement §1.274-5(c) and (f) as proposed on March 25, 1997, in the **Federal Register** (62 F.R. 14051). Conforming changes to §1.62-2 are also proposed.

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, 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 adopting these proposed regulations as final regulations, consideration will be given to any comments that are submitted timely (and in the manner described in the ADDRESSES portion of this preamble) to the IRS. All comments will be available for public inspection and copying. A public hearing will be scheduled and held upon request by any person who submits comments on the proposed rules. Notice of the time and place for the hearing will be published in the **Federal Register**.

Drafting Information

The principal authors of these proposed regulations are Edwin B. Cleverdon and Donna M. Crisalli, Office of the Assistant Chief Counsel (Income Tax and Accounting). However, personnel from other offices of 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. In §1.62–2, paragraph (e)(2) is revised to read as follows:

§1.62–2 Reimbursement and other expense allowance arrangements.

* * * * *

(e) * * *

(2) *Expenses governed by section 274(d).* An arrangement that reimburses travel, entertainment, use of a passenger automobile or other listed property, or other business expenses governed by section 274(d) meets the requirements of this paragraph (e)(2) if information sufficient to satisfy the substantiation requirements of section 274(d) and the regulations thereunder is submitted to the payor. See §1.274–5T. Under section 274(d), information sufficient to substantiate the requisite elements of each expenditure or use must be submitted to the payor. For example, with respect to travel away from home, §1.274–5T(b)(2) requires that information sufficient to substantiate the amount, time, place, and business purpose of the expense must be submitted to the payor. Similarly, with respect to use of a passenger automobile or other listed property, §1.274–5T(b)(6) requires that information sufficient to substantiate the amount, time, use, and business purpose of the expense must be submitted to the payor. See §1.274–5(g), however, which grants the Commissioner authority to prescribe rules permitting the amount of certain expenses to be deemed substantiated to the payor (in lieu of substantiating the actual amount of such expenses) by means of per diem or mileage rates for travel away from home or transportation expenses. See also §1.274–5(j)(1), which grants the Commissioner the authority to establish a method under which a taxpayer may use a specified amount for meals while traveling away from home in lieu of substantiating the actual cost of

meals, and §1.274–5(j)(2), which grants the Commissioner the authority to establish a method under which a taxpayer may use mileage rates to determine the amount of the ordinary and necessary expenses of using an automobile for local transportation and transportation to, from, and at the destination while traveling away from home in lieu of substantiating the actual costs. Substantiation of the amount of a business expense in accordance with rules prescribed pursuant to the authority granted by §1.274–5(g) or (j) will be treated as substantiation of the amount of such expense for purposes of this section.

* * * * *

§1.62–2T [Removed]

Par. 3. Section 1.62–2T is removed.

Par. 4. Section 1.274–5 is added to read as follows:

§1.274–5 Substantiation requirements.

(a) through (f) [Reserved]. For further guidance, see §1.274–5T(a) through (f).

(g) *Substantiation by reimbursement arrangements or per diem, mileage, and other traveling allowances—(1) In general.* The Commissioner may, in his or her discretion, prescribe rules in pronouncements of general applicability under which allowances for expenses described in paragraph (g)(2) of this section will, in accordance with reasonable business practice, be regarded as equivalent to substantiation by adequate records or other sufficient evidence for purposes of §1.274–5T(c) of the amount of such expenses and as satisfying, with respect to the amount of such expenses, the requirements of an adequate accounting to the employer for purposes of §1.274–5T(f)(4). If the total allowance received exceeds the deductible expenses paid or incurred by the employee, such excess must be reported as income on the employee’s return. See paragraph (j)(1) of this section relating to the substantiation of meal expenses while traveling away from home, and paragraph (j)(2) of this section relating to the substantiation of expenses for the business use of an automobile.

(2) *Allowances for expenses described.* An allowance for expenses is described in this paragraph (g)(2) if it is a—

(i) Reimbursement arrangement covering ordinary and necessary expenses of

traveling away from home (exclusive of transportation expenses to and from destination);

(ii) Per diem allowance providing for ordinary and necessary expenses of traveling away from home (exclusive of transportation costs to and from destination); or

(iii) Mileage allowance providing for ordinary and necessary expenses of local transportation and transportation to, from, and at the destination while traveling away from home.

(3) *Limitation.* For expenses paid or incurred on or before December 31, 1997, a mileage allowance described in paragraph (g)(2)(iii) of this section is available only to the owner of a vehicle.

(h) and (i) [Reserved]. For further guidance, see §1.274–5T(h) and (i).

(j) *Authority for optional methods of computing certain expenses—(1) Meal expenses while traveling away from home.* The Commissioner may establish a method under which a taxpayer may use a specified amount or amounts for meals while traveling away from home in lieu of substantiating the actual cost of meals. The taxpayer would not be relieved of the requirement to substantiate the actual cost of other travel expenses as well as the time, place, and business purpose of the travel. See §1.274–5T(b)(2) and (c).

(2) *Use of mileage rates for automobile expenses.* The Commissioner may establish a method under which a taxpayer may use mileage rates to determine the amount of the ordinary and necessary expenses of using an automobile for local transportation and transportation to, from, and at the destination while traveling away from home in lieu of substantiating the actual costs. Such method may include appropriate limitations and conditions in order to reflect more accurately automobile expenses over the entire period of usage. The taxpayer would not be relieved of the requirement to substantiate the amount of each business use (i.e., the business mileage), or the time and business purpose of each use. See §1.274–5T(b)(2) and (c).

(k) and (l) [Reserved]. For further guidance, see §1.274–5T(k) and (l).

(m) *Effective date.* Paragraphs (g) and (j) of this section apply to expenses paid or incurred after December 31, 1997.

§1.274-5T [Amended]

Par. 5. Paragraphs (g) and (j) of §1.274-5T are removed and reserved.

§1.274(d)-1T [Removed]

Par. 7. Section 1.274(d)-1T is removed.

(Filed by the Office of the Federal Register on September 30, 1998, 8:45 a.m., and published in the issue of the Federal Register for October 1, 1998, 63 F.R. 52660)

§1.274(d)-1 [Amended]

Par. 6. Section 1.274(d)-1 is amended by removing paragraph (a)(3).

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

Announcement 98-90

Proposed Changes to Form 8849

Purpose

The purpose of this announcement is to request public comments on the proposed changes to Form 8849, Claim for Refund of Excise Taxes.

Note: The Form 8849 and Schedules shown are subject to change and OMB approval before final release.

Proposed changes to Form 8849

The proposed changes include the following:

- Six schedules are provided, five for fuel tax claims and one for other claims.
- Fuel tax claims that have similar requirements are made on the same schedule.
- Entry boxes are provided for data on the form and schedules.

Benefits of the changes

The revised Form 8849 will:

- Allow the claimant to use only the applicable schedules;
- Reduce the number of separate statements and attachments required to be prepared by the claimant;
- Reduce the amount of correspondence with IRS because of incomplete claims;
- Provide adequate space to enter the required information; and
- Allow the IRS to use improved data processing techniques for increased efficiency.

Comments requested

The IRS would like to receive comments on the proposed changes to Form 8849 from interested parties by November 15, 1998. Send written comments to:

Chairman, Tax Forms Coordinating Committee
Internal Revenue Service, OP:FS:FP, Room 5577
1111 Constitution Avenue, NW
Washington, D.C. 20224

Alternatively, you may send comments to the Chairman, TFCC, by fax at (202) 622-5025, or e-mail to tfp-mail@publish.no.irs.gov

After the end of the comment period, the IRS will evaluate the documents received and announce the final changes to the Form 8849. Although we will not be able to respond to each comment, we will carefully consider all of them.

Claim for Refund of Excise Taxes

(Rev. October 1998)

OMB No. 1545-1420

Please print in ALL CAPITAL LETTERS. Leave a single space between words.

Name of claimant

Name of claimant grid

Employer identification number (EIN)

Employer identification number (EIN) grid

Address (number, street, room or suite no.)

Address grid

Social security number (SSN)

Social security number (SSN) grid

City and state or province (Foreign addresses, include postal code as appropriate.)

City and state or province grid

ZIP code

ZIP code grid

Foreign country, if applicable. Do not abbreviate.

Foreign country grid

Month income tax year ends

Month income tax year ends grid

Caution: Do not claim any amounts on Form 8849 that were or will be claimed on Schedule C (Form 720), Adjustments and Claims, or Form 4136, Credit for Federal Tax Paid on Fuels.

Schedules Attached

Check the box for each schedule that is attached.

Table with 2 columns: Schedule number and description, and a checkbox. Schedules include Nontaxable Use of Fuels, Sales by Registered Ultimate Vendors of Undyed Kerosene and Undyed Diesel Fuel, Gasohol Blending, Sales by Gasoline Wholesale Distributors, Section 4081(e), and Other Claims.

Under penalties of perjury, I declare that I have examined this claim, including accompanying schedules and statements, and to the best of my knowledge and belief, it is true, correct, and complete, and that amounts claimed on this form have not been, and will not be, claimed on any other form.

Sign Here

Signature

Date

Daytime telephone number

(Please type or print your name below signature.)

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 20027J

Form 8849 (Rev. 10-98)

**Schedule 1
(Form 8849)**

Department of the Treasury—Internal Revenue Service

Nontaxable Use of Fuels

(Rev. October 1998)

▶ Attach to Form 8849.

OMB No. 1545-1420

Name as shown on page 1

EIN or SSN

Period of claim ▶	From									To									
--------------------------	-------------	--	--	--	--	--	--	--	--	-----------	--	--	--	--	--	--	--	--	--

1 Nontaxable Use of Gasoline/Gasohol	(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of refund	(e) CRN
a Gasoline					301
b Gasohol containing at least 10% alcohol					
c Gasohol containing at least 7.7% alcohol but less than 10% alcohol					312
d Gasohol containing at least 5.7% alcohol but less than 7.7% alcohol					

2 Nontaxable Use of Aviation Gasoline	(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of refund	(e) CRN
a Use in commercial aviation (other than foreign trade)					307
b Other nontaxable use					

3 Nontaxable Use of Undyed Kerosene or Undyed Diesel Fuel

Claimant certifies that the fuel did not contain visible evidence of dye.

Exception. If any of the fuel included in this claim did contain visible evidence of dye, attach a detailed explanation and check here

Claimant has the name and address of the person(s) who sold the fuel to the claimant and the date(s) of the purchase(s) and if exported, the required proof of export.

Caution: Claims for the tax paid on fuel used on a farm for farming purposes, for the exclusive use of a state or local government or kerosene sold from a blocked pump cannot be made on line 3. Only registered ultimate vendors may make those claims.

	(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of refund	(e) CRN
a Nontaxable use (excluding use on a farm for farming purposes or exclusive use of a state or local government)					303
b Trains					305
c Certain intercity or local buses					303

4 Nontaxable Use of Aviation Fuel (other than gasoline)

	(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of refund	(e) CRN
a Use in commercial aviation (other than foreign trade)					310
b Other nontaxable use					

5 Use of LPG in Certain Buses

	(a) Type of use	(b) Rate	(c) Gallons	(d) Amount of refund	(e) CRN
a Intercity and local buses					304
b Qualified local and school buses					

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 20027J

Schedule 1 (Form 8849) (Rev. 10-98)

**Schedule 2
(Form 8849)**

Department of the Treasury—Internal Revenue Service

**Sales by Registered Ultimate Vendors
of Undyed Kerosene and Undyed Diesel Fuel**

(Rev. October 1998)

▶ Attach to Form 8849.

OMB No. 1545-1420

Name as shown on page 1

EIN or SSN

1 Sales by Ultimate Vendors of Undyed Kerosene

Claimant certifies that the kerosene did not contain visible evidence of dye.

Exception: If any of the kerosene included in this claim **did** contain visible evidence of dye, attach a detailed explanation and check here

Claimant sold the kerosene at a tax-excluded price, repaid the amount of tax to the buyer, or obtained written consent of the buyer to make the claim; and obtained any required certificate from the buyer and has no reason to believe any information in the certificate is false.

Period of claim ▶ From To

Registration No. ▶ U P

a Sales from a blocked pump	(a) Rate	(b) Gallons	(c) Amount of refund	(d) CRN
	<input type="text"/>	<input type="text"/>	<input type="text"/>	303

Note: UV registrants must complete line 3 below.

Period of claim ▶ From To

Registration No. ▶ U V

b Use on a farm for farming purposes	<input type="text"/>	<input type="text"/>	<input type="text"/>	303
c Use by a state or local government	<input type="text"/>	<input type="text"/>	<input type="text"/>	

2 Sales by Ultimate Vendors of Undyed Diesel Fuel

Claimant certifies that the diesel fuel did not contain visible evidence of dye.

Exception: If any of the diesel fuel included in this claim **did** contain visible evidence of dye, attach a detailed explanation and check here

Claimant sold the fuel at a tax-excluded price, repaid the amount of tax to the buyer, or obtained written consent of the buyer to make the claim; and obtained the required certificate from the buyer and has no reason to believe any information in the certificate is false.

Period of claim ▶ From To

Note: UV registrants must complete line 3 below.

Registration No. ▶ U V

a Use on a farm for farming purposes	<input type="text"/>	<input type="text"/>	<input type="text"/>	303
b Use by a state or local government	<input type="text"/>	<input type="text"/>	<input type="text"/>	

3 Farmer or Government Unit Information

For lines 1b, 1c, 2a, and 2b above, enter the information below for each farmer, custom harvester, or governmental unit to whom the fuel was sold. If more space is needed, attach an additional sheet.

Taxpayer identification no.	Name	Gallons
<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>
<input type="text"/>	<input type="text"/>	<input type="text"/>

**Schedule 3
(Form 8849)**

Department of the Treasury—Internal Revenue Service

Gasohol Blending

(Rev. October 1998)

▶ Attach to Form 8849.

OMB No. 1545-1420

Name as shown on page 1

EIN or SSN

Claimant certifies that it bought gasoline taxed at the full rate and blended it with alcohol to make gasohol. The gasohol was **used or sold for use in a trade or business**. For **each batch** of gasohol, claimant has the required information relating to the purchase of the gasoline and alcohol used to make the gasohol and to support the amount claimed.

Period of claim ▶ From

--	--	--	--	--	--	--	--	--	--

 To

--	--	--	--	--	--	--	--	--	--

Percentage of Alcohol in the Gasohol	(a) Gallons	(b) Rate	(c) Amount of refund	(d) CRN																														
1 At least 10% alcohol																																		
Gasoline	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											302
Alcohol	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>																																	

Percentage of Alcohol in the Gasohol	(a) Gallons	(b) Rate	(c) Amount of refund	(d) CRN																														
2 At least 7.7% alcohol but less than 10% alcohol																																		
Gasoline	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											302
Alcohol	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>																																	

Percentage of Alcohol in the Gasohol	(a) Gallons	(b) Rate	(c) Amount of refund	(d) CRN																														
3 At least 5.7% alcohol but less than 7.7% alcohol																																		
Gasoline	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>											302
Alcohol	<table border="1"><tr><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td><td> </td></tr></table>																																	

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 20027J

Schedule 3 (Form 8849) (Rev. 10-98)

**Schedule 4
(Form 8849)**

Department of the Treasury—Internal Revenue Service

Sales by Gasoline Wholesale Distributors

(Rev. October 1998)

▶ Attach to Form 8849.

OMB No. 1545-1420

Name as shown on page 1

EIN or SSN

Claimant certifies that it bought gasoline, gasohol, or aviation gasoline at a price that included the excise tax. Claimant qualifies as a gasoline wholesale distributor, sold the fuel at a tax-excluded price, and obtained a certificate of ultimate purchaser or proof of export from the buyer.

Type of Fuel	(a) Type of use	(b) Rate	(c) Gallons	Period of claim ▶		(d) Amount of refund	(e) CRN
				From	To		
1 Gasoline							301
2 Gasohol containing at least 10% alcohol							
3 Gasohol containing at least 7.7% alcohol but less than 10% alcohol							312
4 Gasohol containing at least 5.7% alcohol but less than 7.7% alcohol							
5 Aviation gasoline							307

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 20027J

Schedule 4 (Form 8849) (Rev. 10-98)

**Schedule 5
(Form 8849)**

(Rev. October 1998)

Department of the Treasury—Internal Revenue Service

Section 4081(e)

▶ Attach to Form 8849.

OMB No. 1545-1420

Name as shown on page 1

EIN or SSN

Part I Claim for Refund of Second Tax

Type of fuel	Period of claim ▶		(a) Total amount of refund	(b) CRN
	From	To		
1 Gasoline				301
2 Diesel/kerosene				303
3 Aviation gasoline				307

Part II Supporting Information Required (See instructions.) If more space is needed, attach separate sheets.

Claimant certifies that the amount of the second tax has not been included in the price of the fuel, and has not been collected from the purchaser. Claimant has attached a copy of the First Taxpayer's Report, and if applicable, a copy of the Statement of Subsequent Seller.

A

(a) Gallons of fuel claimed

(b) Amount of second tax paid

(c) Date second liability incurred

(d) Filing date of Form 720 reporting second liability

B

(a) Gallons of fuel claimed

(b) Amount of second tax paid

(c) Date second liability incurred

(d) Filing date of Form 720 reporting second liability

C

(a) Gallons of fuel claimed

(b) Amount of second tax paid

(c) Date second liability incurred

(d) Filing date of Form 720 reporting second liability

For Privacy Act and Paperwork Reduction Act Notice, see instructions.

Cat. No. 20027J

Schedule 5 (Form 8849) (Rev. 10-98)

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

Under 330, Title 31 of the United States Code, the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents, or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents, and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employ-

ing, 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 such disbarred or suspended practitioners, 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 or disbarred and will be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing before an administrative law judge, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Galt, Edward G.	Monterey, CA	CPA	October 25, 1997
Lopez, Andrew L.	Albuquerque, NM	CPA	December 11, 1997
Branch, Jimmie L.	Jacksonville, FL	CPA	January 15, 1998
Harrison, Rebecca A.	Carmichael, CA	Enrolled Agent	March 4, 1998
Mayer, Robert J.	Wexford, PA	CPA	June 4, 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, en-

rolled 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 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
Clark, Sheila	Houston, TX	CPA	Indefinite from April 21, 1998
Kimes, Larry W.	Austin, TX	Attorney	Indefinite from May 5, 1998
Braiteman, Sheldon	Baltimore, MD	Attorney	Indefinite from June 5, 1998
Pollack, Michael	Guttenberg, NJ	Attorney	Indefinite from June 11, 1998
Eichenbaum, Irving	Huntingdon Valley, PA	CPA	Indefinite from August 4, 1998
Corley, Francis R.	Irmo, SC	CPA	Indefinite from August 4, 1998
Scott, Richard	Lincoln, NE	Attorney	Indefinite from August 4, 1998
Wilson, Douglas D.	Roanoke, VA	Attorney	Indefinite from August 4, 1998
Watkins, Brian R.	Lincoln, NE	Attorney	Indefinite
Congdon Jr., Byron E.	San Bernadino, CA	Attorney	Indefinite from August 4, 1998
Abrams, Robert	Elmsford, NY	CPA	Indefinite from August 4, 1998
Robinson, Doane	Rapid City, SD	CPA	Indefinite from August 4, 1998
Szarwark, Ernest	Nashville, TN	Attorney	Indefinite from August 4, 1998
Roberts, Mark	Norman, OK	CPA	Indefinite from August 4, 1998
Wood, Randall K.	Springfield, MO	Attorney	Indefinite from August 5, 1998
Chappell, Ronald L.	Antelope, CA	CPA	Indefinite from August 12, 1998

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 Ser-

vice 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 ac-

countant, 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
Makula, John G.	Park Ridge, IL	CPA	April 1, 1998 to March 31, 2003
Slomski, Michael	Gross Pointe Woods, MI	CPA	April 1, 1998 to March 31, 2001
Bozeman Jr., T. Alvin	Sylvester, GA	CPA	May 22, 1998 to November 21, 1999
Parness, Richard A.	Westfield, NJ	CPA	June 1, 1998 to December 31, 1998
Register, Billy	Havana, FL	CPA	Indefinite from July 10, 1998
Cooper, Michael E.	Edina, MN	CPA	August 19, 1998 to February 18, 1999
Minello, Michael J.	Clarks Summit, PA	CPA	August 28, 1998 to April 27, 2001
Holden, William W.	Fairfield, CT	CPA	September 1, 1998 to March 31, 1999
Freeman, Samuel	Bedford, NH	CPA	September 1, 1998 to August 31, 1999
Anders, Kevin	Williamport, MD	CPA	September 1, 1998 to August 31, 2001
Breed, Robert M.	Concord, MA	CPA	September 1, 1998 to February 28, 2001
Sandirk, Paula Brooks	Chehalis, WA	CPA	November 1, 1998 to April 30, 2000
Neuhaus Jr., George	Brewster, NY	CPA	November 1, 1998 to April 30, 2000

Definition of Terms

Revenue rulings and revenue procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified*, below).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it ap-

plies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

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

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

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.

E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPFH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.

PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedural Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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¹ A cumulative list of all revenue rulings, revenue procedures, Treasury decisions, etc., published in Internal Revenue Bulletins 1998–1 through 1998–28 will be found in Internal Revenue Bulletin 1998–29, dated July 20, 1998.

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