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DEPARTMENT OF THE TREASURY

Corrected June 29, 2006

Internal Revenue Service

26 CFR Part 1

REG-111578-06

RIN 1545-BF56

Computer Software Under Section 199(c)(5)(B)

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In the Rules and Regulations section of this issue of the **Federal Register**, the IRS is issuing temporary regulations concerning the application of section 199 of the Internal Revenue Code, which provides a deduction for income attributable to domestic production activities, to certain transactions involving computer software. The text of those regulations also serves as the text of these proposed regulations. This document also provides notice of a public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 30, 2006.

Outlines of topics to be discussed at the public hearing scheduled for Tuesday, August 29, 2006, must be received by August 8, 2006.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-111578-06), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to: CC:PA:LPD:PR (REG-111578-06), Courier Desk, Internal

Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the IRS Internet site at www.irs.gov/regs or via the Federal eRulemaking Portal at www.regulations.gov (IRS - REG-111578-06). The public hearing will be held in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Paul Handleman or Lauren Ross Taylor, (202) 622-3040; concerning submission of comments, the hearing, and/or to be placed on the building access list to attend the hearing, Richard A. Hurst, (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

Temporary regulations in the Rules and Regulations section of this issue of the **Federal Register** amend the Income Tax Regulations (26 CFR Part 1) relating to section 199. The temporary regulations provide guidance under section 199 for taxpayers providing computer software to customers for the customers' direct use while connected to the Internet. The text of those regulations also serves as the text of these proposed regulations. The preamble to the temporary regulations explains the amendments.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It 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 their impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any written comments (a signed original and eight (8) copies) or electronic comments that are submitted timely to the IRS. Comments are requested on all aspects of the proposed regulations. In addition, the IRS and Treasury Department specifically request comments on the clarity of the proposed rules and how they can be made easier to understand. All comments will be available for public inspection and copying.

A public hearing has been scheduled for Tuesday, August 29, 2006, at 10 a.m. in the IRS Auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the AFOR FURTHER INFORMATION CONTACT@ section of this preamble.

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

Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (a signed original and eight (8) copies) by August 8, 2006. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal authors of these regulations are Paul Handleman and Lauren Ross Taylor, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

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 * * *

Section 1.199-3 also issued under 26 U.S.C. 199(d). * * *
Section 1.199-8 also issued under 26 U.S.C. 199(d). * * *

Par. 2. Section 1.199-3 is amended to read as follows:

'1.199-3 Domestic production gross receipts.

[The text of the amendments to this proposed section is the same as the text of
' 1.199-3T published elsewhere in this issue of the **Federal Register.**]

Par. 3. Section 1.199-8 is amended to read as follows:

§1.199-8 Other rules.

[The text of the amendments to this proposed section is the same as the text of
' 1.199-8T published elsewhere in this issue of the **Federal Register.**]

Mark E. Matthews,

Deputy Commissioner for Services and Enforcement.