Internal Revenue
bulletin

Bulletin No. 1998–7
February 17, 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. 8745, page 15.

Final regulations under section 280B of the Code relate to deductions available upon demolition of a building.

T.D. 8746, page 4.

Final regulations under section 171 of the Code relate to the federal income tax treatment of bond premium and bond issuance premium.

T.D. 8747, page 18.

Final regulations under section 1396 of the Code relate to the period employers may use in computing the empowerment zone employment credit.

T.D. 8749, page 16.

Final regulations under section 1202 of the Code relate to the 50-percent exclusion for gain from certain small business stock.

EXEMPT ORGANIZATIONS

Rev. Proc. 98–19, page 30.

Organizations excepted from reporting lobbying expenditures. This procedure provides guidance to organizations exempt from taxation under Code section 501(a) on the application of amendments made to Code sections 162(e) and 6033(e) by section 13222 of the Omnibus Budget Reconciliation Act of 1993. Rev. Procs. 95–35 and 95–35A superseded.

Announcement 98–10, page 35.

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

GIFT TAX

Rev. Rul. 98–8, page 24.

Disposition of qualifying income interest. If a surviving spouse acquires the remainder interest in a trust subject to a QTIP election under section 2056(b)(7) of the Code in connection with the transfer by the surviving spouse of property or cash to the holder of the remainder interest, the surviving spouse makes a gift under sections 2511, 2512, and 2519 of the Code.

T.D. 8743, page 26.

Final regulations under section 2702 of the Code permit the reformation of a personal residence trust or a qualified personal residence trust in order to comply with the applicable requirements for such trusts.

T.D. 8744, page 20.

Final regulations under section 2518 of the Code relate to the treatment of disclaimers for estate and gift tax purposes.

EMPLOYMENT TAX

Announcement 98–9, page 35.

This announcement provides corrections to the 1998 Circular E, Employer's Tax Guide (Publication 15).

ADMINISTRATIVE

Rev. Proc. 98–20, page 32.

This procedure sets forth the acceptable form of written assurances that will except the sale or exchange of a principal residence from information reporting.

Finding Lists begin on page 40.
Announcement of Disbarments and Suspensions begins on page 37.

Department of the Treasury
Internal Revenue Service

Mission of the Service

The purpose of the Internal Revenue Service is to collect the proper amount of tax revenue at the least cost; serve the public by continually improving the quality of our products and services; and perform in a manner warranting the highest degree of public confidence in our integrity, efficiency, and fairness.

Statement of Principles of Internal Revenue Tax Administration

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

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

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

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

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

Introduction

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

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

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

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

The Bulletin is divided into four parts as follows:

Part I.—1986 Code.

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

Part II.—Treaties and Tax Legislation.

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

Part III.—Administrative, Procedural, and Miscellaneous.

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

Part IV.—Items of General Interest.

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

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

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

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

Section 121.—Exclusion of Gain From Sale of Principal Residence

Guidance is provided on the acceptable form of written assurances (certification) that a real estate reporting person must obtain from the seller of a principal residence to except such sale or exchange from the information reporting requirements for real estate transactions under section 6045(e)(5). See Rev. Proc. 98–20, page 32.

Section 162.—Trade or Business Expenses

26 CFR 1.162–20: Expenditures attributable to lobbying, political campaigns, attempts to influence legislation, etc., and certain advertising.

This revenue procedure provides guidance to organizations exempt from taxation under § 501(a) of the Internal Revenue Code of 1986 on the application of amendments made to §§ 162(e) and 6033(e) by § 13222 of the Omnibus Budget Reconciliation Act of 1993. The revenue procedure identifies certain tax-exempt organizations that will be treated as satisfying the requirements of § 6033(e)(3). Those organizations will not be subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2). Procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3) are also provided. Rev. Proc. 95–35, 1995–2 C.B. 391, and Rev. Proc. 95–35A, 1995–2 C.B. 392, are superseded. See Rev. Proc. 98–19, page 30.

Section 171.—Amortizable Bond Premium

26 CFR 1.171: Bond premium.

T.D. 8746

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

Amortizable Bond Premium

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the federal income tax treatment of bond premium and bond issuance premium. The regulations reflect changes to the law made by the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988. The regulations will provide needed guidance to holders and issuers of debt instruments.

DATES: *Effective Date:* March 2, 1998.

Applicability date: For dates of applicability of the final regulations, s**ee Effective Dates** under SUPPLEMENTARY INFORMATION.

FOR FURTHER INFORMATION CONTACT: William E. Blanchard, (202) 622-3950 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collections of information contained in these final regulations have been reviewed and approved by the Office of Management and Budget in accordance with the requirements of the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)) under control number 1545-1491. Responses to these collections of information are required by the IRS to determine whether a holder of a bond has elected to amortize bond premium and whether an issuer or a holder has changed its method of accounting for premium.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent varies from 0.25 hours to 0.75 hours, depending on individual circumstances, with an estimated average of 0.5 hours.

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

Books or records relating to the collections 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

Sections 1.171-1 through 1.171-4 of the Income Tax Regulations were promulgated in 1957 and last amended in 1968. In the Tax Reform Act of 1986, section 171(b) was amended to require that bond premium be amortized by reference to a constant yield. In the Technical and Miscellaneous Revenue Act of 1988, section 171(e) was amended to require that amortizable bond premium be treated as an offset to interest income.

On June 27, 1996, the IRS published a notice of proposed rulemaking in the **Federal Register** (61 F.R. 33396 [FI–48–95, 1996–2 C.B. 449]) relating to the federal income tax treatment of bond premium and bond issuance premium. A public hearing was not held because no one requested to speak at the hearing that had been scheduled for October 23, 1996. The IRS did receive a few comments on the proposed regulations. The proposed regulations, with certain changes to respond to the comments, are adopted as final regulations.

Explanation of Provisions

In general, bond premium arises when a holder acquires a bond for more than the principal amount of the bond. Similarly, bond issuance premium arises when an issuer issues a bond for more than the principal amount of the bond. A holder will purchase, and an issuer will issue, a bond for more than its principal amount when the stated interest rate on the bond is higher than the current market yield for the bond.

The holder's treatment of bond premium is addressed in §§1.171–1 through 1.171–5. The issuer's treatment of bond issuance premium is addressed in §1.163–13. In each case, the amortization of premium is based on constant yield principles. For this reason, the final regulations use concepts and definitions from the original issue discount (OID) regulations (in general, see §§1.1271–1 through 1.1275–7T).

Determination of Bond Premium

Under the proposed regulations, bond premium is defined as the excess of a

holder's basis in a bond over the sum of the remaining amounts payable on the bond other than payments of qualified stated interest. The holder generally determines the amount of bond premium as of the date the holder acquires the bond.

The proposed regulations provide special rules that limit a holder's basis solely for purposes of determining bond premium. For example, if a bond is convertible into stock of the issuer at the holder's option, for purposes of determining bond premium, the holder must reduce its basis in the bond by the value of the conversion option. This reduction prevents the holder from inappropriately amortizing the cost of the embedded conversion option.

The final regulations adopt the rules of the proposed regulations for determining the amount of bond premium, if any, on a bond. However, in response to comments, the final regulations clarify the determination of basis in the case of a convertible bond acquired in a transferred basis transaction.

Amortization of Bond Premium

(a) In general

Under section 171, the holder of a taxable bond acquired at a premium may elect to amortize bond premium. The holder of a tax-exempt bond acquired at a premium must amortize the premium. As premium is amortized, the holder's basis in the bond is reduced by a corresponding amount under section 1016(a)(5).

Under the proposed regulations, a holder amortizes bond premium by offsetting qualified stated interest income with bond premium. An offset is calculated for each accrual period using constant yield principles. However, the offset for an accrual period is only taken into account when the holder takes qualified stated interest into account under the holder's regular method of accounting. Thus, a holder using the cash receipts and disbursements method of accounting does not take bond premium into account until a qualified stated interest payment is received.

The final regulations adopt the rules in the proposed regulations for amortizing bond premium.

(b) Excess premium

For certain bonds (for example, bonds that pay a variable rate of interest or that provide for an interest holiday), the amount of bond premium allocable to an accrual period could exceed the amount of qualified stated interest allocable to that period. The proposed regulations address this situation by providing that the excess bond premium is not allowed as a deduction but is carried forward to future accrual periods.

Several commentators stated that this excess premium should be allowable as a current deduction for the accrual period in which the excess occurs. In response to these comments, the final regulations adopt rules for excess premium that are similar to the rules for negative adjustments on contingent payment debt instruments and deflation adjustments on inflation-indexed debt instruments. Under the final regulations, any excess bond premium allocable to an accrual period is deductible by the holder under section 171(a)(1) for the accrual period. The amount deductible, however, is limited by the amount of the holder's prior income inclusions on the bond. If any of the excess bond premium is not deductible under section 171(a)(1), this amount is carried forward to the next accrual period and is treated as bond premium allocable to that period.

Bonds Subject to Certain Contingencies

If a bond provides for one or more alternative payment schedules, the yield of the bond cannot be determined without making assumptions about the actual payment schedule. The OID regulations provide rules for making these assumptions. For example, the rules assume that an issuer will exercise a call option if doing so would minimize the yield of the debt instrument and that a holder will exercise a put option if doing so would maximize the yield of the debt instrument.

The proposed regulations under section 171 generally use similar assumptions to determine the holder's yield on a bond that provides for alternative payment schedules. However, in the case of an issuer's option on a taxable bond, the proposed regulations reverse the assumption in the OID regulations by assuming that the issuer will exercise the option only if doing so would increase the yield on the bond. See section 171(b)(1)(B)(ii). Thus, under the proposed regulations, a holder generally must amortize bond premium on a taxable bond by reference to the stated maturity date, even if it appears likely the bond will be called. In this case, if the bond is actually called, the proposed regulations provide that the holder may deduct the unamortized premium. If the bond is partially called and the partial call is not a pro-rata prepayment, the proposed regulations do not allow the holder to deduct a portion of the unamortized premium. Instead, the holder must recompute the yield of the bond on the date of the partial call and amortize the remaining premium by reference to the recomputed yield.

In general, the final regulations adopt the rules of the proposed regulations. In response to a comment, the final regulations limit the issuer rule for taxable bonds to call options.

Bond Issuance Premium

Under existing §1.61–12(c), a corporate issuer treats premium received upon issuance of a bond as a separate item of income. Over the term of the bond, the premium is taken into income, and the full amount of the stated interest is deducted. The proposed regulations revise the treatment of bond issuance premium. Under the proposed regulations, bond issuance premium is amortized as an offset to the issuer's otherwise allowable interest deduction, not as a separate item of income. The amount of bond issuance premium amortized in any period is based on a constant yield. In addition, the proposed regulations apply to all issuers, not just corporate issuers.

In general, the final regulations adopt the rules in the proposed regulations for bond issuance premium. However, the final regulations contain several important changes from the proposed regulations. First, in response to comments, the final regulations clarify the treatment of a debt instrument subject to an alternative payment schedule by explicitly cross-referencing §1.1272–1(c). Second, the final regulations provide that, in the case of a debt instrument subject to a mandatory sinking fund provision, the issuer must determine the payment schedule by assuming that a pro rata portion of the debt instrument will be called under the sinking fund provision. This rule produces more economic interest accruals than the

accruals determined by ignoring the sinking fund provision as under the proposed regulations. Third, the final regulations adopt rules for excess bond issuance premium allocable to an accrual period. These rules are similar to the rules for excess bond premium described above.

Aggregation Rules

Although the proposed regulations do not provide for an aggregate method of accounting for premium, comments were requested on the need for an aggregate method. Because no comments were received, the final regulations do not provide rules for an aggregate method of accounting for premium.

Bonds Not Subject to the Final Regulations

The final regulations generally apply to bonds acquired or issued at a premium. Certain bonds, however, are excluded from the application of the final regulations. For example, the final regulations exclude debt instruments described in section 1272(a)(6)(C) (regular interests in a REMIC, qualified mortgages held by a REMIC, and certain other debt instruments, or pools of debt instruments, with payments subject to acceleration). No inference is intended regarding the treatment of debt instruments described in section 1272(a)(6)(C).

Effective Dates

The final regulations relating to bond premium are effective for bonds acquired on or after March 2, 1998. However, if a holder makes the election to amortize bond premium for the taxable year containing March 2, 1998, or any subsequent taxable year, the regulations apply to bonds held on or after the first day of the taxable year in which the election is made.

The final regulations relating to bond issuance premium apply to debt instruments issued on or after March 2, 1998.

The final regulations also provide automatic consent for a taxpayer to change its method of accounting for premium in certain circumstances. Because the change is made on a cut-off basis, no items of income or deduction are omitted or duplicated. Therefore, no adjustment under section 481 is allowed.

Special Analyses

It is hereby certified that these regulations do not have significant economic impact on a substantial number of small entities. This certification is based upon the fact that the regulations merely require a taxpayer to attach to the taxpayer's return a statement that indicates whether the taxpayer is making an election under section 171 or is changing its accounting method for bond premium or bond issuance premium. Therefore, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required.

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking was submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Drafting Information

Several persons from the Office of Assistant Chief Counsel (Financial Institutions and Products) and the Treasury Department participated in the development of these regulations.

* * * * *

Adoption of Amendments to the Regulations

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

PART 1—INCOME TAXES

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

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

Section 1.171–2 also issued under 26 U.S.C. 171(e).

Section 1.171–3 also issued under 26 U.S.C. 171(e).

Section 1.171–4 also issued under 26 U.S.C. 171(c). * * *

Par. 2. Section 1.61–12 is amended by revising paragraph (c) to read as follows:

§1.61–12 Income from discharge of indebtedness.

* * * * *

(c) *Issuance and repurchase of debt instruments*—(1) *Issuance.* An issuer does not realize gain or loss upon the issuance of a debt instrument. For rules relating to an issuer's interest deduction for a debt instrument issued with bond issuance premium, see §1.163–13.

(2) *Repurchase*—(i) *In general.* An issuer does not realize gain or loss upon the repurchase of a debt instrument. However, if a debt instrument provides for payments denominated in, or determined by reference to, a nonfunctional currency, an issuer may realize a currency gain or loss upon the repurchase of the instrument. See section 988 and the regulations thereunder. For purposes of this paragraph (c)(2), the term *repurchase* includes the retirement of a debt instrument, the conversion of a debt instrument into stock of the issuer, and the exchange (including an exchange under section 1001) of a newly issued debt instrument for an existing debt instrument.

(ii) *Repurchase at a discount.* An issuer realizes income from the discharge of indebtedness upon the repurchase of a debt instrument for an amount less than its adjusted issue price (within the meaning of §1.1275–1(b)). The amount of discharge of indebtedness income is equal to the excess of the adjusted issue price over the repurchase price. See section 108 and the regulations thereunder for additional rules relating to income from discharge of indebtedness. For example, to determine the repurchase price of a debt instrument that is repurchased through the issuance of a new debt instrument, see section 108(e)(10).

(iii) *Repurchase at a premium.* An issuer may be entitled to a repurchase premium deduction upon the repurchase of a debt instrument for an amount greater than its adjusted issue price (within the meaning of §1.1275–1(b)). See §1.163– 7(c) for the treatment of repurchase premium.

(iv) *Effective date.* This paragraph (c)(2) applies to debt instruments repurchased on or after March 2, 1998.

* * * * *

Par. 3. Section 1.163-13 is added to read as follows:

§1.163–13 Treatment of bond issuance premium.

(a) *General rule.* If a debt instrument is issued with bond issuance premium, this section limits the amount of the issuer's interest deduction otherwise allowable under section 163(a). In general, the issuer determines its interest deduction by offsetting the interest allocable to an accrual period with the bond issuance premium allocable to that period. Bond issuance premium is allocable to an accrual period based on a constant yield. The use of a constant yield to amortize bond issuance premium is intended to generally conform the treatment of debt instruments having bond issuance premium with those having original issue discount. Unless otherwise provided, the terms used in this section have the same meaning as those terms in section 163(e), sections 1271 through 1275, and the corresponding regulations. Moreover, unless otherwise provided, the provisions of this section apply in a manner consistent with those of section 163(e), sections 1271 through 1275, and the corresponding regulations. In addition, the anti-abuse rule in §1.1275–2(g) applies for purposes of this section. For rules dealing with the treatment of bond premium by a holder, see §§1.171–1 through 1.171–5.

(b) *Exceptions.* This section does not apply to—

(1) A debt instrument described in section 1272(a)(6)(C) (regular interests in a REMIC, qualified mortgages held by a REMIC, and certain other debt instruments, or pools of debt instruments, with payments subject to acceleration); or

(2) A debt instrument to which §1.1275–4 applies (relating to certain debt instruments that provide for contingent payments).

(c) *Bond issuance premium.* Bond issuance premium is the excess, if any, of the issue price of a debt instrument over its stated redemption price at maturity. For purposes of this section, the issue price of a convertible bond (as defined in §1.171–1(e)(1)(iii)(C)) does not include an amount equal to the value of the conversion option (as determined under §1.171–1(e)(1)(iii)(A)).

(d) *Offsetting qualified stated interest with bond issuance premium*—(1) *In general.* An issuer amortizes bond issuance premium by offsetting the qualified stated interest allocable to an accrual period with the bond issuance premium allocable to the accrual period. This offset occurs when the issuer takes the qualified stated interest into account under its regular method of accounting.

(2) *Qualified stated interest allocable to an accrual period.* See §1.446–2(b) to determine the accrual period to which qualified stated interest is allocable and to determine the accrual of qualified stated interest within an accrual period.

(3) *Bond issuance premium allocable to an accrual period.* The bond issuance premium allocable to an accrual period is determined under this paragraph (d)(3). Within an accrual period, the bond issuance premium allocable to the period accrues ratably.

(i) *Step one: Determine the debt instrument's yield to maturity.* The yield to maturity of a debt instrument is determined under the rules of §1.1272–1(b)(1)(i).

(ii) *Step two: Determine the accrual periods.* The accrual periods are determined under the rules of §1.1272–1(b)(1)(ii).

(iii) *Step three: Determine the bond issuance premium allocable to the accrual period.* The bond issuance premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period over the product of the adjusted issue price at the beginning of the accrual period and the yield. In performing this calculation, the yield must be stated appropriately taking into account the length of the particular accrual period. Principles similar to those in §1.1272–1(b)(4) apply in determining the bond issuance premium allocable to an accrual period.

(4) *Bond issuance premium in excess of qualified stated interest*—(i) *Ordinary income.* If the bond issuance premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period, the excess is treated as ordinary income by the issuer for the accrual period. However, the amount treated as ordinary income is limited to the amount by which the issuer's total interest deductions on the debt instrument in prior accrual periods exceed the total amount treated by the issuer as ordinary income on the debt instrument in prior accrual periods.

(ii) *Carryforward.* If the bond issuance premium allocable to an accrual period exceeds the sum of the qualified stated interest allocable to the accrual period and the amount treated as ordinary income for the accrual period under paragraph (d)(4)(i) of this section, the excess is carried forward to the next accrual period and is treated as bond issuance premium allocable to that period. If a carryforward exists on the date the debt instrument is retired, the carryforward is treated as ordinary income on that date.

(e) *Special rules*—(1) *Variable rate debt instruments.* An issuer determines bond issuance premium on a variable rate debt instrument by reference to the stated redemption price at maturity of the equivalent fixed rate debt instrument constructed for the variable rate debt instrument. The issuer also allocates any bond issuance premium among the accrual periods by reference to the equivalent fixed rate debt instrument. The issuer constructs the equivalent fixed rate debt instrument, as of the issue date, by using the principles of §1.1275–5(e).

(2) *Inflation-indexed debt instruments.* An issuer determines bond issuance premium on an inflation-indexed debt instrument by assuming that there will be no inflation or deflation over the term of the instrument. The issuer also allocates any bond issuance premium among the accrual periods by assuming that there will be no inflation or deflation over the term of the instrument. The bond issuance premium allocable to an accrual period offsets qualified stated interest allocable to the period. Notwithstanding paragraph (d)(4) of this section, if the bond issuance premium allocable to an accrual period exceeds the qualified stated interest allocable to the period, the excess is treated as a deflation adjustment under §1.1275–7T(f)(1)(ii). See §1.1275–7T for other rules relating to inflation-indexed debt instruments.

(3) *Certain debt instruments subject to contingencies*—(i) *In general.* Except as provided in paragraph (e)(3)(ii) of this section, the rules of §1.1272–1(c) apply to determine a debt instrument's payment schedule for purposes of this section. For example, an issuer uses the payment schedule determined under §1.1272–1(c) to determine the amount, if any, of bond issuance premium on the debt instrument, the yield and maturity of the debt instru-

ment, and the allocation of bond issuance premium to an accrual period.

(ii) *Mandatory sinking fund provision.* Notwithstanding paragraph (e)(3)(i) of this section, if a debt instrument is subject to a mandatory sinking fund provision described in §1.1272–1(c)(3), the issuer must determine the payment schedule by assuming that a pro rata portion of the debt instrument will be called under the sinking fund provision.

(4) *Remote and incidental contingencies.* For purposes of determining the amount of bond issuance premium and allocating bond issuance premium among accrual periods, if a bond provides for a contingency that is remote or incidental (within the meaning of §1.1275–2(h)), the issuer takes the contingency into account under the rules for remote and incidental contingencies in §1.1275–2(h).

(f) *Example.* The following example illustrates the rules of this section:

Example—(i) *Facts.* On February 1, 1999, X issues for $110,000 a debt instrument maturing on February 1, 2006, with a stated principal amount of $100,000, payable at maturity. The debt instrument provides for unconditional payments of interest of $10,000, payable on February 1 of each year. X uses the calendar year as its taxable year, X uses the cash receipts and disbursements method of accounting, and X decides to use annual accrual periods ending on February 1 of each year. X's calculations assume a 30-day month and 360-day year.

(ii) *Amount of bond issuance premium.* The issue price of the debt instrument is $110,000. Because the interest payments on the debt instrument are qualified stated interest, the stated redemption price at maturity of the debt instrument is $100,000. Therefore, the amount of bond issuance premium is $10,000 ($110,000–$100,000).

(iii) *Bond issuance premium allocable to the first accrual period.* Based on the payment schedule and the issue price of the debt instrument, the yield of the debt instrument is 8.07 percent, compounded annually. (Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention.) The bond issuance premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($10,000) over the product of the adjusted issue price at the beginning of the period ($110,000) and the yield (8.07 percent, compounded annually). Therefore, the bond issuance premium allocable to the accrual period is $1,118.17 ($10,000– $8,881.83).

(iv) *Premium used to offset interest.* Although X makes an interest payment of $10,000 on February 1, 2000, X only deducts interest of $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with the bond issuance premium allocable to the period ($1,118.17).

(g) *Effective date.* This section applies to debt instruments issued on or after March 2, 1998.

(h) *Accounting method changes*—(1) *Consent to change.* An issuer required to change its method of accounting for bond issuance premium to comply with this section must secure the consent of the Commissioner in accordance with the requirements of §1.446–1(e). Paragraph (h)(2) of this section provides the Commissioner's automatic consent for certain changes.

(2) *Automatic consent.* The Commissioner grants consent for an issuer to change its method of accounting for bond issuance premium on debt instruments issued on or after March 2, 1998. Because this change is made on a cut-off basis, no items of income or deduction are omitted or duplicated and, therefore, no adjustment under section 481 is allowed. The consent granted by this paragraph (h)(2) applies provided—

(i) The change is made to comply with this section;

(ii) The change is made for the first taxable year for which the issuer must account for a debt instrument under this section; and

(iii) The issuer attaches to its federal income tax return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

Par. 4. Sections 1.171-1 through 1.171-4 are revised to read as follows:

§1.171–1 Bond premium.

(a) *Overview*—(1) *In general.* This section and §§1.171–2 through 1.171–5 provide rules for the determination and amortization of bond premium by a holder. In general, a holder amortizes bond premium by offsetting the interest allocable to an accrual period with the premium allocable to that period. Bond premium is allocable to an accrual period based on a constant yield. The use of a constant yield to amortize bond premium is intended to generally conform the treatment of bond premium to the treatment of original issue discount under sections 1271 through 1275. Unless otherwise provided, the terms used in this section and §§1.171–2 through 1.171–5 have the same meaning as those terms in sections 1271 through 1275 and the corresponding regulations. Moreover, unless otherwise provided, the provisions of this section and §§1.171–2 through 1.171–5 apply in a manner consistent with those of sections 1271 through 1275 and the corresponding regulations. In addition, the anti-abuse rule in §1.1275–2(g) applies for purposes of this section and §§1.171–2 through 1.171–5.

(2) *Cross-references.* For rules dealing with the adjustments to a holder's basis to reflect the amortization of bond premium, see §1.1016–5(b). For rules dealing with the treatment of bond issuance premium by an issuer, see §1.163–13.

(b) *Scope*—(1) *In general.* Except as provided in paragraph (b)(2) of this section and §1.171–5, this section and §§1.171–2 through 1.171–4 apply to any bond that, upon its acquisition by the holder, is held with bond premium. For purposes of this section and §§1.171–2 through 1.171–5, the term bond has the same meaning as the term debt instrument in §1.1275–1(d).

(2) *Exceptions.* This section and §§1.171–2 through 1.171–5 do not apply to—

(i) A bond described in section 1272(a)(6)(C) (regular interests in a REMIC, qualified mortgages held by a REMIC, and certain other debt instruments, or pools of debt instruments, with payments subject to acceleration);

(ii) A bond to which §1.1275–4 applies (relating to certain debt instruments that provide for contingent payments);

(iii) A bond held by a holder that has made a §1.1272–3 election with respect to the bond;

(iv) A bond that is stock in trade of the holder, a bond of a kind that would properly be included in the inventory of the holder if on hand at the close of the taxable year, or a bond held primarily for sale to customers in the ordinary course of the holder's trade or business; or

(v) A bond issued before September 28, 1985, unless the bond bears interest and was issued by a corporation or by a government or political subdivision thereof.

(c) *General rule*—(1) *Tax-exempt obligations.* A holder must amortize bond premium on a bond that is a tax-exempt obligation. See §1.171–2(c) Example 4.

(2) *Taxable bonds.* A holder may elect to amortize bond premium on a taxable bond. Except as provided in paragraph (c)(3) of this section, a taxable bond is any bond other than a tax-exempt obligation. See §1.171–4 for rules relating to

the election to amortize bond premium on a taxable bond.

(3) Bonds the interest on which is partially excludable. For purposes of this section and §§1.171–2 through 1.171–5, a bond the interest on which is partially excludable from gross income is treated as two instruments, a tax-exempt obligation and a taxable bond. The holder's basis in the bond and each payment on the bond are allocated between the two instruments based on a reasonable method.

(d) *Determination of bond premium*—(1) *In general.* A holder acquires a bond at a premium if the holder's basis in the bond immediately after its acquisition by the holder exceeds the sum of all amounts payable on the bond after the acquisition date (other than payments of qualified stated interest). This excess is bond premium, which is amortizable under §1.171–2.

(2) *Additional rules for amounts payable on certain bonds.* Additional rules apply to determine the amounts payable on a variable rate debt instrument, an inflation-indexed debt instrument, a bond that provides for certain alternative payment schedules, and a bond that provides for remote or incidental contingencies. See §1.171–3.

(e) *Basis.* A holder determines its basis in a bond under this paragraph (e). This determination of basis applies only for purposes of this section and §§1.171–2 through 1.171–5. Because of the application of this paragraph (e), the holder's basis in the bond for purposes of these sections may differ from the holder's basis for determining gain or loss on the sale or exchange of the bond.

(1) *Determination of basis*—(i) *In general.* In general, the holder's basis in the bond is the holder's basis for determining loss on the sale or exchange of the bond.

(ii) *Bonds acquired in certain exchanges.* If the holder acquired the bond in exchange for other property (other than in a reorganization defined in section 368) and the holder's basis in the bond is determined in whole or in part by reference to the holder's basis in the other property, the holder's basis in the bond may not exceed its fair market value immediately after the exchange. See paragraph (f) *Example 1* of this section. If the bond is acquired in a reorganization, see section 171(b)(4)(B).

(iii) *Convertible bonds*—(A) *General rule.* If the bond is a convertible bond, the holder's basis in the bond is reduced by an amount equal to the value of the conversion option. The value of the conversion option may be determined under any reasonable method. For example, the holder may determine the value of the conversion option by comparing the market price of the convertible bond to the market prices of similar bonds that do not have conversion options. See paragraph (f) *Example 2* of this section.

(B) *Convertible bonds acquired in certain exchanges.* If the bond is a convertible bond acquired in a transaction described in paragraph (e)(1)(ii) of this section, the holder's basis in the bond may not exceed its fair market value immediately after the exchange reduced by the value of the conversion option.

(C) *Definition of convertible bond.* A convertible bond is a bond that provides the holder with an option to convert the bond into stock of the issuer, stock or debt of a related party (within the meaning of section 267(b) or 707(b)(1)), or into cash or other property in an amount equal to the approximate value of such stock or debt.

(2) *Basis in bonds held by certain transferees.* Notwithstanding paragraph (e)(1) of this section, if the bond is transferred basis property (as defined in section 7701(a)(43)) and the transferor had acquired the bond at a premium, the holder's basis in the bond is—

(i) The holder's basis for determining loss on the sale or exchange of the bond; reduced by

(ii) Any amounts that the transferor could not have amortized under this paragraph (e) or under §1.171–4(c), except to the extent that the holder's basis already reflects a reduction attributable to such nonamortizable amounts.

(f) *Examples.* The following examples illustrate the rules of this section:

Example 1. Bond received in liquidation of a partnership interest—(i) *Facts.* PR is a partner in partnership PRS. PRS does not have any unrealized receivables or inventory items as defined in section 751. On January 1, 1998, PRS distributes to PR a taxable bond, issued by an unrelated corporation, in liquidation of PR's partnership interest. At that time, the fair market value of PR's partnership interest is $40,000 and the basis is $100,000. The fair market value of the bond is $40,000.

(ii) *Determination of basis.* Under section 732(b), PR's basis in the bond is equal to PR's basis in the partnership interest. Therefore, PR's basis for determining loss on the sale or exchange of the bond is $100,000. However, because the distribution is treated as an exchange for purposes of section 171(b)(4), PR's basis in the bond is $40,000 for purposes of this section and §§1.171–2 through 1.171–5. See paragraph (e)(1)(ii) of this section.

Example 2. Convertible bond—(i) *Facts.* On January 1, 1998, A purchases for $1,100 B corporation's bond maturing on January 1, 2001, with a stated principal amount of $1,000, payable at maturity. The bond provides for unconditional payments of interest of $30 on January 1 and July 1 of each year. In addition, the bond is convertible into 15 shares of B corporation stock at the option of the holder. On January 1, 1998, B corporation's nonconvertible, publicly-traded, three-year debt with a similar credit rating trades at a price that reflects a yield of 6.75 percent, compounded semiannually.

(ii) *Determination of basis.* A's basis for determining loss on the sale or exchange of the bond is $1,100. As of January 1, 1998, discounting the remaining payments on the bond at the yield at which B's similar nonconvertible bonds trade (6.75 percent, compounded semiannually) results in a present value of $980. Thus, the value of the conversion option is $120. Under paragraph (e)(1)(iii)(A) of this section, A's basis is $980 ($1,100–$120) for purposes of this section and §§1.171–2 through 1.171–5. The sum of all amounts payable on the bond other than qualified stated interest is $1,000. Because A's basis (as determined under paragraph (e)(1)(iii)(A) of this section) does not exceed $1,000, A does not acquire the bond at a premium.

§1.171–2 Amortization of bond premium.

(a) *Offsetting qualified stated interest with premium*—(1) *In general.* A holder amortizes bond premium by offsetting the qualified stated interest allocable to an accrual period with the bond premium allocable to the accrual period. This offset occurs when the holder takes the qualified stated interest into account under the holder's regular method of accounting.

(2) *Qualified stated interest allocable to an accrual period.* See §1.446–2(b) to determine the accrual period to which qualified stated interest is allocable and to determine the accrual of qualified stated interest within an accrual period.

(3) *Bond premium allocable to an accrual period.* The bond premium allocable to an accrual period is determined under this paragraph (a)(3). Within an accrual period, the bond premium allocable to the period accrues ratably.

(i) *Step one: Determine the holder's yield.* The holder's yield is the discount rate that, when used in computing the present value of all remaining payments to be made on the bond (including payments of qualified stated interest), produces an amount equal to the holder's basis in the

bond as determined under §1.171–1(e). For this purpose, the remaining payments include only payments to be made after the date the holder acquires the bond. The yield is calculated as of the date the holder acquires the bond, must be constant over the term of the bond, and must be calculated to at least two decimal places when expressed as a percentage.

(ii) *Step two: Determine the accrual periods.* A holder determines the accrual periods for the bond under the rules of §1.1272–1(b)(1)(ii).

(iii) *Step three: Determine the bond premium allocable to the accrual period.* The bond premium allocable to an accrual period is the excess of the qualified stated interest allocable to the accrual period over the product of the holder's adjusted acquisition price (as defined in paragraph (b) of this section) at the beginning of the accrual period and the holder's yield. In performing this calculation, the yield must be stated appropriately taking into account the length of the particular accrual period. Principles similar to those in §1.1272–1(b)(4) apply in determining the bond premium allocable to an accrual period.

(4) *Bond premium in excess of qualified stated interest*—(i) *Taxable bonds*—(A) *Bond premium deduction.* In the case of a taxable bond, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period, the excess is treated by the holder as a bond premium deduction under section 171(a)(1) for the accrual period. However, the amount treated as a bond premium deduction is limited to the amount by which the holder's total interest inclusions on the bond in prior accrual periods exceed the total amount treated by the holder as a bond premium deduction on the bond in prior accrual periods. A deduction determined under this paragraph (a)(4)(i)(A) is not subject to section 67 (the 2-percent floor on miscellaneous itemized deductions). See *Example 1* of §1.171–3(e).

(B) *Carryforward.* If the bond premium allocable to an accrual period exceeds the sum of the qualified stated interest allocable to the accrual period and the amount treated as a deduction for the accrual period under paragraph (a)(4)(i)(A) of this section, the excess is carried forward to the next accrual period and is treated as bond premium allocable to that period.

(ii) *Tax-exempt obligations.* In the case of a tax-exempt obligation, if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to the accrual period, the excess is a nondeductible loss. If a regulated investment company (RIC) within the meaning of section 851 has excess bond premium for an accrual period that would be a nondeductible loss under the prior sentence, the RIC must use this excess bond premium to reduce its tax-exempt interest income on other tax-exempt obligations held during the accrual period.

(5) *Additional rules for certain bonds.* Additional rules apply to determine the amortization of bond premium on a variable rate debt instrument, an inflation-indexed debt instrument, a bond that provides for certain alternative payment schedules, and a bond that provides for remote or incidental contingencies. See §1.171–3.

(b) *Adjusted acquisition price.* The adjusted acquisition price of a bond at the beginning of the first accrual period is the holder's basis as determined under §1.171–1(e). Thereafter, the adjusted acquisition price is the holder's basis in the bond decreased by—

(1) The amount of bond premium previously allocable under paragraph (a)(3) of this section; and

(2) The amount of any payment previously made on the bond other than a payment of qualified stated interest.

(c) *Examples.* The following examples illustrate the rules of this section. Each example assumes the holder uses the calendar year as its taxable year and has elected to amortize bond premium, effective for all relevant taxable years. In addition, each example assumes a 30-day month and 360-day year. Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention. The examples are as follows:

Example 1. Taxable bond—(i) *Facts.* On February 1, 1999, A purchases for $110,000 a taxable bond maturing on February 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $10,000, payable on February 1 of each year. A uses the cash receipts and disbursements method of accounting, and A decides to use annual accrual periods ending on February 1 of each year.

(ii) *Amount of bond premium.* The interest payments on the bond are qualified stated interest. Therefore, the sum of all amounts payable on the bond (other than the interest payments) is $100,000. Under §1.171–1, the amount of bond premium is $10,000 ($110,000–$100,000).

(iii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the bond and A's basis in the bond, A's yield is 8.07 percent, compounded annually. The bond premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($10,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and A's yield (8.07 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $1,118.17 ($10,000–$8,881.83).

(iv) *Premium used to offset interest.* Although A receives an interest payment of $10,000 on February 1, 2000, A only includes in income $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,118.17). Under §1.1016–5(b), A's basis in the bond is reduced by $1,118.17 on February 1, 2000.

Example 2. Alternative accrual periods—(i) *Facts.* The facts are the same as in *Example 1* of this paragraph (c) except that A decides to use semiannual accrual periods ending on February 1 and August 1 of each year.

(ii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the bond and A's basis in the bond, A's yield is 7.92 percent, compounded semiannually. The bond premium allocable to the accrual period ending on August 1, 1999, is the excess of the qualified stated interest allocable to the period ($5,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and A's yield, stated appropriately taking into account the length of the accrual period (7.92 percent/2). Therefore, the bond premium allocable to the accrual period is $645.29 ($5,000–$4,354.71). Although the accrual period ends on August 1, 1999, the qualified stated interest of $5,000 is not taken into income until February 1, 2000, the date it is received. Likewise, the bond premium of $645.29 is not taken into account until February 1, 2000. The adjusted acquisition price of the bond on August 1, 1999, is $109,354.71 (the adjusted acquisition price at the beginning of the period ($110,000) less the bond premium allocable to the period ($645.29)).

(iii) *Bond premium allocable to the second accrual period.* Because the interval between payments of qualified stated interest contains more than one accrual period, the adjusted acquisition price at the beginning of the second accrual period must be adjusted for the accrued but unpaid qualified stated interest. See paragraph (a)(3)(iii) of this section and §1.1272–1(b)(4)(i)(B). Therefore, the adjusted acquisition price on August 1, 1999, is $114,354.71 ($109,354.71 + $5,000). The bond premium allocable to the accrual period ending on February 1, 2000, is the excess of the qualified stated interest allocable to the period ($5,000) over the product of the adjusted acquisition price at the beginning of the period ($114,354.71) and A's yield, stated appropriately taking into account the length of the accrual period (7.92 percent/2). Therefore, the bond premium allocable to the accrual period is $472.88 ($5,000–$4,527.12).

(iv) *Premium used to offset interest.* Although A receives an interest payment of $10,000 on February 1, 2000, A only includes in income $8,881.83, the qualified stated interest of $10,000 ($5,000 allocable to the accrual period ending on August 1, 1999, and $5,000 allocable to the accrual period ending on February 1, 2000) offset with bond premium of $1,118.17 ($645.29 allocable to the accrual period ending on August 1, 1999, and $472.88 allocable to the accrual period ending on February 1, 2000). As indicated in *Example 1* of this paragraph (c), this same amount would be taken into income at the same time had A used annual accrual periods.

Example 3. Holder uses accrual method of accounting—(i) Facts. The facts are the same as in *Example 1* of this paragraph (c) except that A uses an accrual method of accounting. Thus, for the accrual period ending on February 1, 2000, the qualified stated interest allocable to the period is $10,000, and the bond premium allocable to the period is $1,118.17. Because the accrual period extends beyond the end of A's taxable year, A must allocate these amounts between the two taxable years.

(ii) *Amounts allocable to the first taxable year.* The qualified stated interest allocable to the first taxable year is $9,166.67 ($10,000 × 11/12). The bond premium allocable to the first taxable year is $1,024.99 ($1,118.17 × 11/12).

(iii) *Premium used to offset interest.* For 1999, A includes in income $8,141.68, the qualified stated interest allocable to the period ($9,166.67) offset with bond premium allocable to the period ($1,024.99). Under §1.1016–5(b), A's basis in the bond is reduced by $1,024.99 in 1999.

(iv) *Amounts allocable to the next taxable year.* The remaining amounts of qualified stated interest and bond premium allocable to the accrual period ending on February 1, 2000, are taken into account for the taxable year ending on December 31, 2000.

Example 4. Tax-exempt obligation—(i) *Facts.* On January 15, 1999, C purchases for $120,000 a tax-exempt obligation maturing on January 15, 2006, with a stated principal amount of $100,000, payable at maturity. The obligation provides for unconditional payments of interest of $9,000, payable on January 15 of each year. C uses the cash receipts and disbursements method of accounting, and C decides to use annual accrual periods ending on January 15 of each year.

(ii) *Amount of bond premium.* The interest payments on the obligation are qualified stated interest. Therefore, the sum of all amounts payable on the obligation (other than the interest payments) is $100,000. Under §1.171–1, the amount of bond premium is $20,000 ($120,000–$100,000).

(iii) *Bond premium allocable to the first accrual period.* Based on the remaining payment schedule of the obligation and C's basis in the obligation, C's yield is 5.48 percent, compounded annually. The bond premium allocable to the accrual period ending on January 15, 2000, is the excess of the qualified stated interest allocable to the period ($9,000) over the product of the adjusted acquisition price at the beginning of the period ($120,000) and C's yield (5.48 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $2,420.55 ($9,000–$6,579.45).

(iv) *Premium used to offset interest.* Although C receives an interest payment of $9,000 on January 15, 2000, C only receives tax-exempt interest income of $6,579.45, the qualified stated interest allocable to the period ($9,000) offset with bond premium allocable to the period ($2,420.55). Under §1.1016–5(b), C's basis in the obligation is reduced by $2,420.55 on January 15, 2000.

§1.171–3 Special rules for certain bonds.

(a) *Variable rate debt instruments.* A holder determines bond premium on a variable rate debt instrument by reference to the stated redemption price at maturity of the equivalent fixed rate debt instrument constructed for the variable rate debt instrument. The holder also allocates any bond premium among the accrual periods by reference to the equivalent fixed rate debt instrument. The holder constructs the equivalent fixed rate debt instrument, as of the date the holder acquires the variable rate debt instrument, by using the principles of §1.1275–5(e). See paragraph (e) *Example 1* of this section.

(b) *Inflation-indexed debt instruments.* A holder determines bond premium on an inflation-indexed debt instrument by assuming that there will be no inflation or deflation over the remaining term of the instrument. The holder also allocates any bond premium among the accrual periods by assuming that there will be no inflation or deflation over the remaining term of the instrument. The bond premium allocable to an accrual period offsets qualified stated interest allocable to the period. Notwithstanding §1.171–2(a)(4), if the bond premium allocable to an accrual period exceeds the qualified stated interest allocable to the period, the excess is treated as a deflation adjustment under §1.1275–7T(f)(1)(i). See §1.1275–7T for other rules relating to inflation-indexed debt instruments.

(c) *Yield and remaining payment schedule of certain bonds subject to contingencies*—(1) *Applicability.* This paragraph (c) provides rules that apply in determining the yield and remaining payment schedule of certain bonds that provide for an alternative payment schedule (or schedules) applicable upon the occurrence of a contingency (or contingencies). This paragraph (c) applies, however, only if the timing and amounts of the payments that comprise each payment schedule are known as of the date the holder acquires the bond (the acquisition date) and the bond is subject to paragraph (c)(2), (3), or (4) of this section. A bond does not provide for an alternative payment schedule merely because there is a possibility of impairment of a payment (or payments) by insolvency, default, or similar circumstances. See §1.1275–4 for the treatment of a bond that provides for a contingency that is not described in this paragraph (c).

(2) *Remaining payment schedule that is significantly more likely than not to occur.* If, based on all the facts and circumstances as of the acquisition date, a single remaining payment schedule for a bond is significantly more likely than not to occur, this remaining payment schedule is used to determine and amortize bond premium under §§1.171–1 and 1.171–2.

(3) *Mandatory sinking fund provision.* Notwithstanding paragraph (c)(2) of this section, if a bond is subject to a mandatory sinking fund provision described in §1.1272–1(c)(3), the provision is ignored for purposes of determining and amortizing bond premium under §§1.171–1 and 1.171–2.

(4) *Treatment of certain options*—(i) *Applicability.* Notwithstanding paragraphs (c)(2) and (3) of this section, the rules of this paragraph (c)(4) determine the remaining payment schedule of a bond that provides the holder or issuer with an unconditional option or options, exercisable on one or more dates during the remaining term of the bond, to alter the bond's remaining payment schedule.

(ii) *Operating rules.* A holder determines the remaining payment schedule of a bond by assuming that each option will (or will not) be exercised under the following rules:

(A) *Issuer options.* In general, the issuer is deemed to exercise or not exercise an option or combination of options in the manner that minimizes the holder's yield on the obligation. However, the issuer of a taxable bond is deemed to exercise or not exercise a call option or combination of call options in the manner that maximizes the holder's yield on the bond.

(B) *Holder options.* A holder is deemed to exercise or not exercise an option or combination of options in the manner that maximizes the holder's yield on the bond.

(C) *Multiple options.* If both the issuer and the holder have options, the rules of paragraphs (c)(4)(ii)(A) and (B) of this section are applied to the options in the order that they may be exercised. Thus,

the deemed exercise of one option may eliminate other options that are later in time.

(5) *Subsequent adjustments*—(i) *In general.* Except as provided in paragraph (c)(5)(ii) of this section, if a contingency described in this paragraph (c) (including the exercise of an option described in paragraph (c)(4) of this section) actually occurs or does not occur, contrary to the assumption made pursuant to paragraph (c) of this section (a change in circumstances), then solely for purposes of section 171, the bond is treated as retired and reacquired by the holder on the date of the change in circumstances for an amount equal to the adjusted acquisition price of the bond as of that date. If, however, the change in circumstances results in a substantially contemporaneous pro-rata prepayment as defined in §1.1275–2(f)(2), the pro-rata prepayment is treated as a payment in retirement of a portion of the bond. See paragraph (e) *Example 2* of this section.

(ii) *Bond premium deduction on the issuer's call of a taxable bond.* If a change in circumstances results from an issuer's call of a taxable bond or a partial call that is a pro-rata prepayment, the holder may deduct as bond premium an amount equal to the excess, if any, of the holder's adjusted acquisition price of the bond over the greater of—

(A) The amount received on redemption; and

(B) The amounts that would have been payable under the bond (other than payments of qualified stated interest) if no change in circumstances had occurred.

(d) *Remote and incidental contingencies.* For purposes of determining and amortizing bond premium, if a bond provides for a contingency that is remote or incidental (within the meaning of §1.1275–2(h)), the holder takes the contingency into account under the rules for remote and incidental contingencies in §1.1275–2(h).

(e) *Examples.* The following examples illustrate the rules of this section. Each example assumes the holder uses the calendar year as its taxable year and has elected to amortize bond premium, effective for all relevant taxable years. In addition, each example assumes a 30-day month and 360-day year. Although, for purposes of simplicity, the yield as stated is rounded to two decimal places, the computations do not reflect this rounding convention. The examples are as follows:

Example 1. Variable rate debt instrument—(i) *Facts.* On March 1, 1999, E purchases for $110,000 a taxable bond maturing on March 1, 2007, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest on March 1 of each year based on the percentage appreciation of a nationally-known commodity index. On March 1, 1999, it is reasonably expected that the bond will yield 12 percent, compounded annually. E uses the cash receipts and disbursements method of accounting, and E decides to use annual accrual periods ending on March 1 of each year. Assume that the bond is a variable rate debt instrument under §1.1275–5.

(ii) *Amount of bond premium.* Because the bond is a variable rate debt instrument, E determines and amortizes its bond premium by reference to the equivalent fixed rate debt instrument constructed for the bond as of March 1, 1999. Because the bond provides for interest at a single objective rate that is reasonably expected to yield 12 percent, compounded annually, the equivalent fixed rate debt instrument for the bond is an eight-year bond with a principal amount of $100,000, payable at maturity. It provides for annual payments of interest of $12,000. E's basis in the equivalent fixed rate debt instrument is $110,000. The sum of all amounts payable on the equivalent fixed rate debt instrument (other than payments of qualified stated interest) is $100,000. Under §1.171–1, the amount of bond premium is $10,000 ($110,000–$100,000).

(iii) *Bond premium allocable to each accrual period.* E allocates bond premium to the remaining accrual periods by reference to the payment schedule on the equivalent fixed rate debt instrument. Based on the payment schedule of the equivalent fixed rate debt instrument and E's basis in the bond, E's yield is 10.12 percent, compounded annually. The bond premium allocable to the accrual period ending on March 1, 2000, is the excess of the qualified stated interest allocable to the period for the equivalent fixed rate debt instrument ($12,000) over the product of the adjusted acquisition price at the beginning of the period ($110,000) and E's yield (10.12 percent, compounded annually). Therefore, the bond premium allocable to the accrual period is $870.71 ($12,000–$11,129.29). The bond premium allocable to all the accrual periods is listed in the following schedule:

Accrual period ending	*Adjusted acquisition price at beginning of accrual period*	*Premium allocable to accrual period*
3/1/00	$110,000.00	$870.71
3/1/01	109,129.29	958.81
3/1/02	108,170.48	1,055.82
3/1/03	107,114.66	1,162.64
3/1/04	105,952.02	1,280.27
3/1/05	104,671.75	1,409.80
3/1/06	103,261.95	1,552.44
3/1/07	101,709.51	1,709.51
		$10,000.00

(iv) *Qualified stated interest for each accrual period.* Assume the bond actually pays the following amounts of qualified stated interest:

Accrual period ending	*Qualified stated interest*
3/1/00	$2,000.00
3/1/01	0.00
3/1/02	0.00
3/1/03	10,000.00
3/1/04	8,000.00
3/1/05	12,000.00
3/1/06	15,000.00
3/1/07	8,500.00

(v) *Premium used to offset interest.* E's interest income for each accrual period is determined by offsetting the qualified stated interest allocable to the period with the bond premium allocable to the period. For the accrual period ending on March 1, 2000, E includes in income $1,129.29, the qualified stated interest allocable to the period ($2,000) offset with the bond premium allocable to the period ($870.71). For the accrual period ending on March 1, 2001, the bond premium allocable to the accrual period ($958.81) exceeds the qualified stated interest allocable to the period ($0) and, therefore, E does not have interest income for this accrual period. However, under §1.171–2(a)(4)(i)(A), E may deduct as bond premium $958.81, the excess of the bond premium allocable to the accrual period ($958.81) over the qualified stated interest allocable to the accrual period ($0). For the accrual period ending on March 1, 2002, the bond premium allocable to the accrual period ($1,055.82) exceeds the qualified stated interest allocable to the accrual period ($0) and, therefore, E does not have interest income for the accrual period. Under §1.171–2(a)(4)(i)(A), E's deduction for bond premium for the accrual period

is limited to $170.48, the excess of E's total interest inclusions on the bond in prior accrual periods ($1,129.29) over the total amount treated by E as a bond premium deduction in prior accrual periods ($958.81). Under §1.171–2(a)(4)(i)(B), E must carry forward the remaining $885.34 of bond premium allocable to the period ending March 1, 2002, and treat it as bond premium allocable to the period ending March 1, 2003. The amount E includes in income for each accrual period is shown in the following schedule:

Accrual period ending	*Qualified stated interest*	*Premium allocable to accrual period*	*Interest income*	*Premium deduction*	*Premium carryforward*
3/1/00	$2,000.00	$870.71	$1,129.29		
3/1/01	0.00	958.81	0.00	$958.81	
3/1/02	0.00	1,055.82	0.00	170.48	$885.34
3/1/03	10,000.00	1,162.64	7,951.93		
3/1/04	8,000.00	1,280.27	6,719.73		
3/1/05	12,000.00	1,409.80	10,590.20		
3/1/06	15,000.00	1,552.44	13,447.56		
3/1/07	8,500.00	1,709.51	6,790.49		
		$10,000.00			

Example 2. Partial call that results in a pro-rata prepayment—(i) *Facts.* On April 1, 1999, M purchases for $110,000 N's taxable bond maturing on April 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $10,000, payable on April 1 of each year. N has the option to call all or part of the bond on April 1, 2001, at a 5 percent premium over the principal amount. M uses the cash receipts and disbursements method of accounting.

(ii) *Determination of yield and the remaining payment schedule.* M's yield determined without regard to the call option is 8.07 percent, compounded annually. M's yield determined by assuming N exercises its call option is 6.89 percent, compounded annually. Under paragraph (c)(4)(ii)(A) of this section, it is assumed N will not exercise the call option because exercising the option would minimize M's yield. Thus, for purposes of determining and amortizing bond premium, the bond is assumed to be a seven-year bond with a single principal payment at maturity of $100,000.

(iii) *Amount of bond premium.* The interest payments on the bond are qualified stated interest. Therefore, the sum of all amounts payable on the bond (other than the interest payments) is $100,000. Under §1.171–1, the amount of bond premium is $10,000 ($110,000–$100,000).

(iv) *Bond premium allocable to the first two accrual periods.* For the accrual period ending on April 1, 2000, M includes in income $8,881.83, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,118.17). The adjusted acquisition price on April 1, 2000, is $108,881.83 ($110,000–$1,118.17). For the accrual period ending on April 1, 2001, M includes in income $8,791.54, the qualified stated interest allocable to the period ($10,000) offset with bond premium allocable to the period ($1,208.46). The adjusted acquisition price on April 1, 2001, is $107,673.37 ($108,881.83–$1,208.46).

(v) *Partial call.* Assume N calls one-half of M's bond for $52,500 on April 1, 2001. Because it was assumed the call would not be exercised, the call is a change in circumstances. However, the partial call is also a pro-rata prepayment within the meaning of §1.1275–2(f)(2). As a result, the call is treated as a retirement of one-half of the bond. Under paragraph (c)(5)(ii) of this section, M may deduct $1,336.68, the excess of its adjusted acquisition price in the retired portion of the bond ($107,673.37/2, or $53,836.68) over the amount received on redemption ($52,500). M's adjusted basis in the portion of the bond that remains outstanding is $53,836.68 ($107,673.37– $53,836.68).

§1.171–4 Election to amortize bond premium on taxable bonds.

(a) *Time and manner of making the election*—(1) *In general.* A holder makes the election to amortize bond premium by offsetting interest income with bond premium in the holder's timely filed federal income tax return for the first taxable year to which the holder desires the election to apply. The holder should attach to the return a statement that the holder is making the election under this section.

(2) *Coordination with OID election.* If a holder makes an election under §1.1272–3 for a bond with bond premium, the holder is deemed to have made the election under this section.

(b) *Scope of election.* The election under this section applies to all taxable bonds held during or after the taxable year for which the election is made.

(c) *Election to amortize made in a subsequent taxable year*—(1) *In general.* If a holder elects to amortize bond premium and holds a taxable bond acquired before the taxable year for which the election is made, the holder may not amortize amounts that would have been amortized in prior taxable years had an election been in effect for those prior years.

(2) *Example.* The following example illustrates the rule of this paragraph (c):

Example—(i) *Facts.* On May 1, 1999, C purchases for $130,000 a taxable bond maturing on May 1, 2006, with a stated principal amount of $100,000, payable at maturity. The bond provides for unconditional payments of interest of $15,000, payable on May 1 of each year. C uses the cash receipts and disbursements method of accounting and the calendar year as its taxable year. C has not previously elected to amortize bond premium, but does so for 2002.

(ii) Amount to amortize. C's basis for determining loss on the sale or exchange of the bond is $130,000. Thus, under §1.171–1, the amount of bond premium is $30,000. Under §1.171–2, if a bond premium election were in effect for the prior taxable years, C would have amortized $3,257.44 of bond premium on May 1, 2000, and $3,551.68 of bond premium on May 1, 2001, based on annual accrual periods ending on May 1. Thus, for 2002 and future years to which the election applies, C may amortize only $23,190.88 ($30,000–$3,257.44–$3,551.68).

(d) *Revocation of election.* The election under this section may not be revoked unless approved by the Commissioner. Because a revocation of the election is a change in accounting method, a taxpayer must follow the rules under §1.446–1(e)(3)(i) to request the Commissioner's consent to revoke the election. A revocation of the election applies to all taxable bonds held during or after the taxable year for which the revocation is effective. The holder may not amortize any remaining bond premium on bonds held at the beginning of the taxable year for which the revocation is effective. Therefore, no adjustment under section 481 is allowed upon the revocation of the election because no items of income or deduction are omitted or duplicated.

Par. 5. Section 1.171–5 is added to read as follows:

§1.171–5 Effective date and transition rules.

(a) *Effective date*—(1) *In general.* Sec-

tions 1.171-1 through 1.171–4 apply to bonds acquired on or after March 2, 1998. However, if a holder makes the election under §1.171–4 for the taxable year containing March 2, 1998, or any subsequent taxable year, §§1.171–1 through 1.171–4 apply to bonds held on or after the first day of the taxable year in which the election is made.

(2) *Transition rule for use of constant yield.* Notwithstanding paragraph (a)(1) of this section, §1.171–2(a)(3) (providing that the bond premium allocable to an accrual period is determined with reference to a constant yield) does not apply to a bond issued before September 28, 1985.

(b) *Coordination with existing election.* A holder is deemed to have made the election under §1.171-4 for the taxable year containing March 2, 1998, if the holder elected to amortize bond premium under section 171 and that election is effective on March 2, 1998. If the holder is deemed to have made the election under §1.171–4 for the taxable year containing March 2, 1998, §§1.171–1 through 1.171–4 apply to bonds acquired on or after the first day of that taxable year. See §1.171–4(d) for rules relating to a revocation of an election under section 171.

(c) *Accounting method changes*—(1) *Consent to change.* A holder required to change its method of accounting for bond premium to comply with §§1.171–1 through 1.171–3 must secure the consent of the Commissioner in accordance with the requirements of §1.446–1(e). Paragraph (c)(2) of this section provides the Commissioner's automatic consent for certain changes. A holder making the election under §1.171–4 does not need the Commissioner's consent to make the election.

(2) *Automatic consent.* The Commissioner grants consent for a holder to change its method of accounting for bond premium with respect to taxable bonds to which §§1.171–1 through 1.171–3 apply. Because this change is made on a cut-off basis, no items of income or deduction are omitted or duplicated and, therefore, no adjustment under section 481 is allowed. The consent granted by this paragraph (c)(2) applies provided—

(i) The holder elected to amortize bond premium under section 171 for a taxable year prior to the taxable year containing March 2, 1998, and that election has not been revoked;

(ii) The change is made for the first taxable year for which the holder must account for a bond under §§1.171–1 through 1.171–3; and

(iii) The holder attaches to its return for the taxable year containing the change a statement that it has changed its method of accounting under this section.

Par. 6. Section 1.249–1 is amended by revising paragraph (c) and the first sentence of paragraph (d)(2) to read as follows:

§1.249–1 Limitation on deduction of bond premium on repurchase.

* * * * *

(c) *Repurchase premium.* For purposes of this section, the term *repurchase premium* means the excess of the repurchase price paid or incurred to repurchase the obligation over its adjusted issue price (within the meaning of §1.1275–1(b)) as of the repurchase date. For the general rules applicable to the deductibility of repurchase premium, see §1.163–7(c). This paragraph (c) applies to convertible obligations repurchased on or after March 2, 1998.

(d) * * *

(2) * * * For a convertible obligation repurchased on or after March 2, 1998, a call premium specified in dollars under the terms of the obligation is considered to be a normal call premium on a nonconvertible obligation if the call premium applicable when the obligation is repurchased does not exceed an amount equal to the interest (including original issue discount) that otherwise would be deductible for the taxable year of repurchase (determined as if the obligation were not repurchased). * * *

* * * * *

Par. 7. Section 1.1016–5 is amended by revising paragraph (b) to read as follows:

§1.1016–5 Miscellaneous adjustments to basis.

* * * * *

(b) *Amortizable bond premium*—(1) *In general.* A holder's basis in a bond is reduced by the amount of bond premium used to offset qualified stated interest income under §1.171–2. This reduction occurs when the holder takes the qualified stated interest into account under the holder's regular method of accounting.

(2) *Special rules for taxable bonds.* A holder's basis in a taxable bond is reduced by the amount of bond premium allowed as a deduction under §1.171–3(c)(5)(ii) (relating to the issuer's call of a taxable bond) or under §1.171–2(a)(4)(i)(A) (relating to excess bond premium).

(3) *Special rule for tax-exempt obligations.* A holder's basis in a tax-exempt obligation is reduced by the amount of excess bond premium that is treated as a nondeductible loss under §1.171– 2(a)-(4)(ii).

* * * * *

§1.1016–9 [Removed]

Par. 8. Section 1.1016–9 is removed.

Par. 9. Section 1.1275–1 is amended by:

1. Redesignating paragraph (b)(2) as paragraph (b)(3). 2. Adding a new paragraph (b)(2).

The addition reads as follows:

§1.1275–1 Definitions.

* * * * *

(b) * * *

(2) *Bond issuance premium.* If a debt instrument is issued with bond issuance premium (as defined in §1.163–13(c)), for purposes of determining the issuer's adjusted issue price, the adjusted issue price determined under paragraph (b)(1) of this section is also decreased by the amount of bond issuance premium previously allocable under §1.163–13(d)(3).

* * * * *

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 10. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 11. Section 602.101, paragraph (c) is amended by:

1. Removing the following entry from the table:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.171–3	1545–0172
* * * * *	

2. Adding entries in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
1.163–13	1545–1491
* * * * *	
1.171–4	1545–1491
1.171–5	1545–1491
* * * * *	

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

Approved December 15, 1997.

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

(Filed by the Office of the Federal Register on December 30, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 31, 1997, 62 F.R. 68173)

Section 280B.—Demolition of Structures

26 CFR 1.280B–1: Demolition of structures.

T.D. 8745

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Definition of Structure

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to deductions available upon demolition of a building. These final regulations reflect changes to the law made by the Tax Reform Act of 1984 and affect owners and lessees of real property who demolish buildings.

DATES: The regulations are effective December 30, 1997.

FOR FURTHER INFORMATION CONTACT: Bernard P. Harvey, (202) 622-3110 (not a toll-free number). For dates of applicability of these regulations, see § 1.280B–1(c).

SUPPLEMENTARY INFORMATION:

Background

This document contains final regulations under section 280B of the Internal Revenue Code. Section 280B was added by the Tax Reform Act of 1976, Public Law 94–455, 2124(b), 90 Stat. 1520, 1918 (Oct. 4, 1976), and significant amendments were made to the provision by the Economic Recovery Tax Act of 1981, Public Law 97–34, 212(d)(2)(C) and (e)(2), 95 Stat. 172, 239 (Aug. 13, 1981) (1981 Act) and the Tax Reform Act of 1984, Public Law 98–369, 1063, 98 Stat. 494, 1047 (July 18, 1984) (1984 Act). Transition rules were provided in the Tax Reform Act of 1986, Public Law 99–514, 1878(h), 100 Stat. 2085, 2904 (Oct. 22, 1986) (1986 Act). As originally enacted, section 280B required any costs or losses incurred on account of the demolition of any certified historic structure (a building or structure meeting certain requirements) to be capitalized into the land upon which the demolished structure was located. The 1981 Act modified the definition of certified historic structure for purposes of section 280B from a building or structure meeting certain requirements to a building (or its structural components) meeting certain requirements. The 1984 Act substituted "any structure" for "certified historic structure."

A notice of proposed rulemaking was published in the **Federal Register** (61 F.R. 31473 [PS–39–93, 1996–2 C.B. 489]) on June 20, 1996. The one written comment received supports the position announced in the notice of proposed rulemaking.

These final regulations define what "structure" means for purposes of section 280B.

Explanation of Provisions

These final regulations define the term "structure" for purposes of section 280B as a building and its structural components as those terms are defined in §1.48–1(e) of the Income Tax Regulations. Thus, under section 280B, a structure will include only a building and its structural components and not other inherently permanent structures such as oil and gas storage tanks, blast furnaces, and coke ovens.

The final regulations rely on the legislative history underlying the 1984 and 1986 Acts, which refer repeatedly to buildings rather than to structures generally. In addition, the legislative history of the 1984 Act discusses the difficulty of applying the intent test of §1.165–3 of the regulations, which applies to the demolition of buildings, and indicates that the newly added language is meant to eliminate this difficulty.

Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations and, because these regulations do not impose on small entities a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, 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 Bernard P. Harvey, Office of Assistant Chief Counsel (Passthroughs and Special Industries). However, other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 1 is 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 1.280B–1 is added to read as follows:

§1.280B–1 Demolition of structures.

(a) *In general.* Section 280B provides that, in the case of the demolition of any structure, no deduction otherwise allowable under chapter 1 of subtitle A shall be allowed to the owner or lessee of such structure for any amount expended for the demolition or any loss sustained on account of the demolition, and that the expenditure or loss shall be treated as properly chargeable to the capital account with respect to the land on which the demolished structure was located.

(b) *Definition of structure.* For purposes of section 280B, the term structure means a building, as defined in §1.48–1(e)(1), including the structural components of that building, as defined in §1.48–1(e)(2).

(c) *Effective date.* This section is effective for demolitions commencing on or after December 30, 1997.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

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

(Filed by the Office of the Federal Register on December 29, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 30, 1997, 62 F.R. 67725)

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

This revenue procedure provides guidance to organizations exempt from taxation under § 501(a) of the Internal Revenue Code of 1986 on the application of amendments made to §§ 162(e) and 6033(e) by § 13222 of the Omnibus Budget Reconciliation Act of 1993. The revenue procedure identifies certain tax-exempt organizations that will be treated as satisfying the requirements of § 6033(e)(3). Those organizations will not be subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2). Procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3) are also provided. Rev. Proc. 95–35, 1995–2 C.B. 391, and Rev. Proc. 95–35A, 1995–2 C.B. 392, are superseded. See Rev. Proc. 98–19, page 30.

Section 1202.—50 Percent Exclusion for Gain From Certain Small Business Stock

26 CFR 1.1202–2: Qualified small business stock; effect of redemptions.

T.D. 8749

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Part 1

Qualified Small Business Stock

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the 50-percent exclusion for gain from certain small business stock. The final regulations reflect changes to the law made by the Omnibus Budget Reconciliation Act of 1993 and provide guidance to the issuers and owners of the stock of certain small businesses.

DATES: This regulation is effective December 31, 1997. For dates of applicability of these regulations, see §1.1202–2(e).

FOR FURTHER INFORMATION CONTACT: Catherine A. Prohofsky of the Office of the Assistant Chief Counsel (Income Tax and Accounting) at 202-622-4930 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

Background

Section 1202 of the Internal Revenue Code allows a taxpayer (other than a corporation) to exclude 50 percent of certain gain from the sale or exchange of qualified small business stock held for more than 5 years. This document contains amendments to the Income Tax Regulations (26 CFR part 1) that provide guidance relating to the effect of redemptions on the availability of this exclusion.

On June 6, 1996, the **Federal Register** published a notice of proposed rulemaking (IA–26–94), 61 F.R. 28821, relating to the effect of certain redemptions on the 50-percent exclusion of gain from the sale or exchange of qualified small business stock under section 1202. The proposed regulations provide that these redemptions are disregarded in determining whether the anti-churning rules of section 1202(c) are violated.

Four comments responding to this notice were received. A public hearing was held on October 3, 1996. After consideration of the comments, the proposed regulations under section 1202 are adopted as modified by this Treasury decision.

Summary of Comments and Modifications

The notice of proposed rulemaking requested comments on how to determine when an independent contractor has terminated services. One commentator suggested that the determination of whether services of an independent contractor were terminated should be based on all the facts and circumstances, with termination conclusively presumed if no further services were provided for six months. The IRS and Treasury Department have not adopted this suggestion, but are continuing to study this issue and request additional comments.

Commentators suggested an additional exception for all redemptions occurring in the ordinary course of business or for legitimate business reasons. The final regulations do not incorporate this suggestion. The exceptions in the final regulations relate to redemptions that are incident to certain events affecting a shareholder. Because of the extraordinary nature of these events and the fact that they are generally not within the control of the issuing corporation, the exceptions are unlikely to lead to avoidance of the requirement that qualified small business stock be purchased at original issue. The IRS and Treasury are concerned, however, that a much broader exception for redemptions that arise out of the ordinary business needs and purposes of the issuing corpo-

ration, and are not incident to extraordinary events affecting its shareholders, would be much more likely to undermine the original issue requirement.

Two commentators requested that the final regulations be effective for stock purchases by an issuing corporation at any time after August 10, 1993. The effective date has been modified in response to this suggestion. The final regulations will apply to stock issued after August 10, 1993. Thus, regardless of the date on which a redemption occurs (or on which the redeemed stock was issued) the redemption is treated as provided in the final regulations for purposes of determining whether stock issued after August 10, 1993, is qualified small business stock.

The Chief Counsel for Advocacy of the Small Business Administration recommended the inclusion of an exception for redemptions occurring in connection with the divorce of a shareholder. This suggestion has been adopted. The final regulations provide that redemptions of stock occurring incident to the divorce of a shareholder are disregarded in determining whether redemptions exceed de minimis amounts.

The Chief Counsel for Advocacy also requested that the IRS and Treasury Department analyze the current use of section 1202. No exclusion under section 1202 can be claimed until 1998 because stock must be issued after August 10, 1993, to be qualified small business stock, and must be held for more than 5 years to qualify for the exclusion. Thus, the available tax return data do not provide the information necessary to analyze the current use of section 1202.

Minor clarifying changes in the regulatory language have also been made.

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C chapter 5) does not apply to these regulations, and because these regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, the notice of proposed rulemaking preceding these final 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 Catherine A. Prohofsky, 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 an entry in numerical order to read as follows:

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

Section 1.1202–2 is also issued under 26 U.S.C. 1202(k). * * *

Par. 2. Sections 1.1202–0 and 1.1202–2 are added to read as follows:

§1.1202–0 Table of contents.

This section lists the major captions that appear in the regulations under §1.1202–2.

§1.1202–2 Qualified small business stock; effect of redemptions.

(a) Redemptions from taxpayer or related person.
(1) In general.
(2) *De minimis* amount.
(b) Significant redemptions.
(1) In general.
(2) *De minimis* amount.
(c) Transfers by shareholders in connection with the performance of services not treated as purchases.
(d) Exceptions for termination of services, death, disability or mental incompetency, or divorce.
(1) Termination of services.
(2) Death.
(3) Disability or mental incompetency.
(4) Divorce.
(e) Effective date.

§1.1202–2 Qualified small business stock; effect of redemptions.

(a) *Redemptions from taxpayer or related person*—(1) *In general.* Stock acquired by a taxpayer is not qualified small business stock if, in one or more purchases during the 4-year period beginning on the date 2 years before the issuance of the stock, the issuing corporation purchases (directly or indirectly) more than a *de minimis* amount of its stock from the taxpayer or from a person related (within the meaning of section 267(b) or 707(b)) to the taxpayer.

(2) *De minimis amount.* For purposes of this paragraph (a), stock acquired from the taxpayer or a related person exceeds a *de minimis* amount only if the aggregate amount paid for the stock exceeds $10,000 and more than 2 percent of the stock held by the taxpayer and related persons is acquired. The following rules apply for purposes of determining whether the 2-percent limit is exceeded. The percentage of stock acquired in any single purchase is determined by dividing the stock's value (as of the time of purchase) by the value (as of the time of purchase) of all stock held (directly or indirectly) by the taxpayer and related persons immediately before the purchase. The percentage of stock acquired in multiple purchases is the sum of the percentages determined for each separate purchase.

(b) *Significant redemptions*—(1) *In general.* Stock is not qualified small business stock if, in one or more purchases during the 2-year period beginning on the date 1 year before the issuance of the stock, the issuing corporation purchases more than a *de minimis* amount of its stock and the purchased stock has an aggregate value (as of the time of the respective purchases) exceeding 5 percent of the aggregate value of all of the issuing corporation's stock as of the beginning of such 2-year period.

(2) *De minimis amount.* For purposes of this paragraph (b), stock exceeds a *de minimis* amount only if the aggregate amount paid for the stock exceeds $10,000 and more than 2 percent of all outstanding stock is purchased. The following rules apply for purposes of determining whether the 2-percent limit is exceeded. The percentage of the stock acquired in any single purchase is determined by dividing the stock's value (as of

the time of purchase) by the value (as of the time of purchase) of all stock outstanding immediately before the purchase. The percentage of stock acquired in multiple purchases is the sum of the percentages determined for each separate purchase.

(c) *Transfers by shareholders in connection with the performance of services not treated as purchases.* A transfer of stock by a shareholder to an employee or independent contractor (or to a beneficiary of an employee or independent contractor) is not treated as a purchase of the stock by the issuing corporation for purposes of this section even if the stock is treated as having first been transferred to the corporation under §1.83–6(d)(1) (relating to transfers by shareholders to employees or independent contractors).

(d) *Exceptions for termination of services, death, disability or mental incompetency, or divorce.* A stock purchase is disregarded if the stock is acquired in the following circumstances:

(1) *Termination of services*—(i) *Employees and directors.* The stock was acquired by the seller in connection with the performance of services as an employee or director and the stock is purchased from the seller incident to the seller's retirement or other bona fide termination of such services;

(ii) *Independent contractors.* [Reserved];

(2) *Death.* Prior to a decedent's death, the stock (or an option to acquire the stock) was held by the decedent or the decedent's spouse (or by both), by the decedent and joint tenant, or by a trust revocable by the decedent or the decedent's spouse (or by both), and—

(i) The stock is purchased from the decedent's estate, beneficiary (whether by bequest or lifetime gift), heir, surviving joint tenant, or surviving spouse, or from a trust established by the decedent or decedent's spouse; and

(ii) The stock is purchased within 3 years and 9 months from the date of the decedent's death;

(3) *Disability or mental incompetency.* The stock is purchased incident to the disability or mental incompetency of the selling shareholder; or

(4) *Divorce.* The stock is purchased incident to the divorce (within the meaning of section 1041(c)) of the selling shareholder.

(e) *Effective date.* This section applies to stock issued after August 10, 1993.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

Approved December 22, 1997.

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

(Filed by the Office of the Federal Register on December 30, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 31, 1997, 62 F.R. 68165)

Section 1396.—Empowerment Zone Employment Credit

26 CFR 1.1396–1: Qualified zone employees.

T.D. 8747

DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

Empowerment Zone Employment Credit

AGENCY: Internal Revenue Service (IRS), Treasury

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the period employers may use in computing the empowerment zone employment credit under section 1396 of the Internal Revenue Code. The regulations reflect and implement certain changes made by the Omnibus Budget Reconciliation Act of 1993 (OBRA '93). They affect employers of employees who live and work in an empowerment zone designated under the statute. The regulations provide employers with the guidance necessary to claim the credit.

DATES: These regulations are effective December 30, 1997. For dates of applicability, see § 1.1396–1(c) of these regulations.

FOR FURTHER INFORMATION CONTACT: Robert G. Wheeler, (202) 622-6060 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On December 16, 1996, a notice of proposed rulemaking [REG–209834–96] containing proposed regulations relating to the period employers may use in computing the empowerment zone employment credit under section 1396 of the Internal Revenue Code was published in the **Federal Register** (61 F.R. 66000).

No written comments responding to this notice were received. No one requested an opportunity to speak at a public hearing. Therefore, no public hearing was held. The regulations proposed by REG–209834–96 are adopted with minor clarifications by this Treasury decision.

Explanation of Provisions

This document contains amendments to the Income Tax Regulations (26 CFR part 1) relating to the empowerment zone employment credit under section 1396. Section 1396 was added to the Internal Revenue Code by the Omnibus Budget Reconciliation Act of 1993 (OBRA'93). Section 1397D of the Code authorizes the Secretary of the Treasury to prescribe regulations that may be necessary or appropriate to carry out the purposes of section 1396.

Section 1396 provides employers with a credit for certain wages (qualified zone wages) paid or incurred by an employer for services performed by a qualifed zone employee. The amount of the empowerment zone employment credit under section 1396 is equal to a specified percentage of the qualified zone wages paid or incurred by the employer during the calendar year that ends with or within the taxable year of the employer. Questions have arisen about the definition of a "qualified zone employee" in section 1396(d). In particular, questions have been raised about the appropriate period under section 1396(d)(1)(A) during which substantially all of the services performed by an employee for his or her employer must be performed within an empowerment zone in a trade or business of the employer.

Under the regulations, an employer may use either each pay period of the calendar year or the entire calendar year as the relevant period in determining

whether a particular employee performed substantially all of his or her services within an empowerment zone (the "location-of-services" requirement). For each taxable year the employer must use the same method for all its employees, but the employer may change methods from one taxable year to the next. The description of the pay period method has been revised slightly to clarify that the relevant pay periods are those for the calendar year with respect to which the credit is being claimed (i.e., the calendar year ending with or within the employer's taxable year).

Special Analyses

It has been determined that this Treasury Decision is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, 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 Robert G. Wheeler, Office of Associate Chief Counsel, Employee Benefits and Exempt Organizations. 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 an entry in numerical order to read as follows:

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

Section 1.1396–1 also issued under 26 U.S.C. 1397D.

Par. 2. A new undesignated center heading and §1.1396-1 are added to read as follows:

Empowerment Zone Employment Credit

§1.1396–1 Qualified zone employees.

(a) *In general.* A qualified zone employee of an employer is an employee who satisfies the location-of-services requirement and the abode requirement with respect to the same empowerment zone and is not otherwise excluded by section 1396(d).

(1) *Location-of-services requirement.* The location-of- services requirement is satisfied if substantially all of the services performed by the employee for the employer are performed in the empowerment zone in a trade or business of the employer.

(2) *Abode requirement.* The abode requirement is satisfied if the employee's principal place of abode while performing those services is in the empowerment zone.

(b) *Period for applying location-of-services requirement.* In applying the location-of-services requirement, an employer may use either the pay period method described in paragraph (b)(1) of this section or the calendar year method described in paragraph (b)(2) of this section. For each taxable year of an employer, the employer must either use the pay period method with respect to all of its employees or use the calendar year method with respect to all of its employees. The employer may change the method applied to all of its employees from one taxable year to the next.

(1) *Pay period method*—(i) *Relevant period.* Under the pay period method, the relevant period for applying the location-of-services requirement is each pay period in which an employee provides services to the employer during the calendar year with respect to which the credit is being claimed (i.e., the calendar year that ends with or within the relevant taxable year). If an employer has one pay period for certain employees and a different pay period for other employees (e.g., a weekly pay period for hourly wage employees and a bi-weekly pay period for salaried employees), the pay period actually applicable to a particular employee is the relevant pay period for that employee under this method.

(ii) *Application of method.* Under this method, an employee does not satisfy the location-of-services requirement during a pay period unless substantially all of the services performed by the employee for the employer during that pay period are performed within the empowerment zone in a trade or business of the employer.

(2) *Calendar year method*—(i) *Relevant period.* Under the calendar year method, the relevant period for an employee is the entire calendar year with respect to which the credit is being claimed. However, for any employee who is employed by the employer for less than the entire calendar year, the relevant period is the portion of that calendar year during which the employee is employed by the employer.

(ii) *Application of method.* Under this method, an employee does not satisfy the location-of-services requirement during any part of a calendar year unless substantially all of the services performed by the employee for the employer during that calendar year (or, if the employee is employed by the employer for less than the entire calendar year, the portion of that calendar year during which the employee is employed by the employer) are performed within the empowerment zone in a trade or business of the employer.

(3) *Examples.* This paragraph (b) may be illustrated by the following examples. In each example, the following assumptions apply. The employees satisfy the abode requirement at all relevant times and all services performed by the employees for their employer are performed in a trade or business of the employer. The employees are not precluded from being qualified zone employees by section 1396(d)(2) (certain employees ineligible). No portion of the employees' wages is precluded from being qualified zone wages by section 1396(c)(2) (only first $15,000 of wages taken into account) or section 1396(c)(3) (coordination with targeted jobs credit and work opportunity credit). The examples are as follows:

Example 1. (i) Employer X has a weekly pay period for all its employees. Employee A works for X throughout 1997. During each of the first 20 weekly pay periods in 1997, substantially all of A's work for X is performed within the empowerment zone in which A resides. A also works in the zone at various times during the rest of the year, but there is no other pay period in which substantially all of A's work for X is performed within the empowerment zone. Employer X uses the pay period method.

(ii) For each of the first 20 pay periods of 1997, A is a qualified zone employee, all of A's wages from X are qualified zone wages, and X may claim the empowerment zone employment credit with respect to those wages. X cannot claim the credit with respect to any of A's wages for the rest of 1997.

Example 2. (i) Employer Y has a weekly pay period for its factory workers and a bi-weekly pay period for its office workers. Employee B works for Y in various factories and Employee C works for Y in various offices. Employer Y uses the pay period method.

(ii) Y must use B's weekly pay periods to determine the periods (if any) in which B is a qualified zone employee. Y may claim the empowerment zone employment credit with respect to B's wages only for the weekly pay periods for which B is a qualified zone employee, because those are B's only wages that are qualified zone wages. Y must use C's bi-weekly pay periods to determine the periods (if any) in which C is a qualified zone employee. Y may claim the credit with respect to C's wages only for the bi-weekly pay periods for which C is a qualified zone employee, because those are C's only wages that are qualified zone wages.

Example 3. (i) Employees D and E work for Employer Z throughout 1997. Although some of D's work for Z in 1997 is performed outside the empowerment zone in which D resides, substantially all of it is performed within that empowerment zone. E's work for Z is performed within the empowerment zone in which E resides for several weeks of 1997 but outside the zone for the rest of the year so that, viewed on an annual basis, E's work is not substantially all performed within the empowerment zone. Employer Z uses the calendar year method.

(ii) D is a qualified zone employee for the entire year, all of D's 1997 wages from Z are qualified zone wages, and Z may claim the empowerment zone employment credit with respect to all of those wages, including the portion attributable to work outside the zone. Under the calendar year method, E is not a qualified zone employee for any part of 1997, none of E's 1997 wages are qualified zone wages, and Z cannot claim any empowerment zone employment credit with respect to E's wages for 1997. Z cannot use the calendar year method for D and the pay period method for E because Z must use the same method for all employees. For 1998, however, Z can switch to the pay period method for E if Z also switches to the pay period method for D and all of Z's other employees.

(c) *Effective date.* This section applies with respect to wages paid or incurred on or after December 21, 1994.

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

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

(Filed by the Office of the Federal Register on December 29, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 30, 1997, 62 F.R. 67726)

Section 2044.—Certain Property for Which Marital Deduction was Previously Allowed

26 CFR 20.2044–1: Certain property for which marital deduction was previously allowed.

What are the gift tax consequences to the surviving spouse of the acquisition by the surviving spouse of the remainder interest in a trust subject to a qualified terminable interest property (QTIP) election under § 2056(b)(7) of the Internal Revenue Code? See Rev. Rul. 98–8, page 24.

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(b)(7): Election with respect to life estate for surviving spouse.

What are the gift tax consequences to the surviving spouse of the acquisition by the surviving spouse of the remainder interest in a trust subject to a qualified terminable interest property (QTIP) election under § 2056(b)(7) of the Internal Revenue Code? See Rev. Rul. 98–8, page 24.

Section 2511.—Transfers in General

26 CFR 25.251–1: Transfers in general.

If a surviving spouse acquires the remainder interest in a trust subject to a QTIP election under § 2056(b)(7) in connection with the transfer by the surviving spouse of property or cash to the holder of the remainder interest, does the surviving spouse make a gift under § 2511 of the Internal Revenue Code? See Rev. Rul. 98–8, page 24.

Section 2512.—Valuation of Gifts

Section 25.2512–8: Transfers for insufficient consideration.

If a surviving spouse acquires the remainder interest in a trust subject to a QTIP election under § 2056(b)(7) in connection with the transfer by the surviving spouse of property or cash to the holder of the remainder interest, what is the value of the gift under § 2512 of the Internal Revenue Code? See Rev. Rul. 98–8, page 24.

Section 2518.—Disclaimers

26 CFR 25.2518–2: Requirements for a qualified disclaimer.

T.D. 8744

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 20 and 25

Disclaimer of Interests and Powers

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final Regulations.

SUMMARY: This document contains final regulations relating to the treatment of disclaimers for estate and gift tax purposes. The regulations clarify certain provisions governing the disclaimer of property interests and powers and, in addition, conform the regulations to court decisions holding the current regulation invalid with respect to the disclaimer of joint property interests. The final regulations will affect persons who disclaim property interests, powers, or interests in jointly owned property.

DATES: *Effective date:* The final regulations are effective December 31, 1997.

Applicability dates: The amendments to §§25.2518–l(a) and 25.2518–2(c)(3) (substituting the statutory language in section 2518(b)(2)(A) "transfer creating the interest," for "taxable transfer") and conforming changes to §§20.2041–3(d)-(6)(i), 20.2046–1, 20.2056(d)–2 (a) and (b), 25.2511–l(c)(1), 25.2514–3(c)(5), are applicable for transfers creating the interest or power to be disclaimed made on or after December 31, 1997. The amendments to §25.2518–2(c)(4) (relating to the disclaimer of joint property and bank accounts) are applicable for disclaimers made on or after December 31, 1997.

FOR FURTHER INFORMATION CONTACT: James F. Hogan (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Background

On August 21, 1996, the IRS published in the **Federal Register** (61 F.R. 43197) a notice of proposed rulemaking (REG–208216–91) amending the regulations under section 2518. The IRS received comments on the proposed regulations; however, no request for a public hearing was received so no public hearing was

held. This document adopts final regulations with respect to this notice of proposed rulemaking.

The proposed regulations substituted the statutory language of section 2518(b)-(2)(A), "transfer creating the interest," for "taxable transfer" as the reference point for determining when the 9-month time period for making the disclaimer commences. This change clarifies that the starting point for the 9-month period is not dependent on the actual imposition of a transfer tax at the time that the interest to be disclaimed is created. Comments with respect to the clarification in the proposed regulation supported the change.

Under the proposed regulations, the one-half survivorship interest in jointly-held property that was unilaterally severable could be disclaimed within 9 months of the date of death of the first joint tenant to die. The proposed regulations did not extend the same treatment to joint interests that are not unilaterally severable (e.g., tenancies by the entirety), but the preamble invited comments on this subject.

The comments received unanimously suggested that a surviving joint tenant should be allowed to disclaim, within 9 months of the date of death of the first joint tenant to die, his or her survivorship interest in a tenancy, whether or not that tenancy is unilaterally severable. The comments noted that parties purchasing a residence often do not make an informed decision regarding whether the residence should be held as joint tenants or tenants by the entirety, and generally are not aware that the decision to take title to the property as either joint tenants with right of survivorship or tenants by the entirety will affect the ability to disclaim their interest in the property after the death of the first joint tenant to die.

Accordingly, the final regulations allow the disclaimer of jointly-held property that is not unilaterally severable on the same basis as joint property that is unilaterally severable. Thus, a surviving joint tenant may disclaim the one-half survivorship interest in property that the joint tenant held either in joint tenancy with right of survivorship or in tenancy by the entirety, within 9 months of the death of the first joint tenant to die. The rule also significantly simplifies the disclaimer of jointly-held property, eliminating certain special rules that were dependent on the application of section 2515 to the creation of the tenancy.

The proposed regulations provided rules regarding the disclaimer of interests in Joint bank accounts and brokerage accounts, generally recognizing that the creation of such accounts are not completed gifts under certain circumstances. Comments noted that other kinds of investment accounts, such as accounts held at mutual funds, accord the parties rights that are similar to the rights of parties with respect to joint bank accounts and brokerage accounts. Accordingly, the final regulations have expanded the special rule with respect to the disclaimer of jointly-held bank and brokerage accounts to include jointly-held investment accounts such as accounts held at mutual funds.

Special Analyses

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

Drafting Information

The principal author of these regulations is Dale Carlton, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

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Adoption of Amendments to the Regulations

Accordingly, 26 CFR parts 20 and 25 are amended as follows:

PART 20—ESTATE TAX; ESTATES OF DECEDENTS DYING AFTER AUGUST 16, 1954

Paragraph 1. The authority citation for part 20 continues to read in part as follows:

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

Par. 2. Section 20.2041–3 is amended as follows:

1. Paragraph (d)(6)(i) is amended by revising the first sentence and by adding a new sentence after the first sentence.

2. Paragraph (d) (6) (iii) is added.

The additions and revisions read as follows:

§20.2041–3 Powers of appointment created after October 21. 1942.

* * * * *

(d) * * *

(6)(i) A disclaimer or renunciation of a general power of appointment created in a transfer made after December 31, 1976, is not considered to be the release of the power if the disclaimer or renunciation i" a qualified disclaimer as described in section 2518 and the corresponding regulations. For rules relating to when the transfer creating the power occurs, see 25.2518–2(c) (3) of this chapter. * * *

* * * * *

(iii) The first and second sentences of paragraph (d)(6)(i) of this section are applicable for transfers creating the power to be disclaimed made on or after December 31, 1997.

* * * * *

Par. 3. Section 20.2046–1 is revised to read as follows:

520.2046–1 Disclaimed property.

(a) This section shall apply to the disclaimer or renunciation of an interest in the person disclaiming by a transfer made after December 31, 1976. For rules relating to when the transfer creating the interest occurs, see §25.2518–2(C) (3) and (c) (4) of this chapter. If a qualified disclaimer is made with respect to such a transfer, the Federal estate tax provisions are to apply with respect to the property interest disclaimed as if the interest had never been transferred to the person making the disclaimer. See section 2518 and the corresponding regulations for rules relating to a qualified disclaimer.

(b) The first and second sentences of this section are applicable for transfers creating the interest to be disclaimed made on or after December 31, 1997.

Par. 4. Section 20.2056 (d)–2 is amended as follows:

1. Paragraph (a) is amended by revising the first sentence and adding a new sentence after the first sentence.

2. Paragraph (b) is revised.

3. A new paragraph (c) is added.

The additions and revisions read as follow:

120.2056(d)–2 Marital deduction: effect of disclaimers of postDecember 31. 1976 transfers.

(a) * * * If a surviving spouse disclaims an interest in property passing to such spouse from the decedent, which interest was created in a transfer made after December 31, 1976, the effectiveness of the disclaimer will be determined by section 2518 and the corresponding regulations. For rules relating to when the transfer creating the interest occurs, see §25.25182(c)(3) and (c)(4) of this chapter. * * *

(b) *Disclaimer by a person other than a surviving spouse.* If an interest in property passes from a decedent to a person other than the surviving spouse, and the interest is created in a transfer made after December 31, 1976, and—

(1) The person other than the surviving spouse makes a qualified disclaimer with respect to such interest; and

(2) The surviving spouse is entitled to such interest in property as a result of such disclaimer, the disclaimed interest is treated as passing directly from the decedent to the surviving spouse. For rules relating to when the transfer creating the interest occurs, see §25.2518–2(c)(3) and (c)(4) of this chapter.

(c) Effective date. The first and second sentences of paragraphs (a) and (b) of this section are applicable for transfers creating the interest to be disclaimed made on or after December 31, 1997.

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Par. 5. The authority citation for part 25 is amended by adding an entry in numerical order to read as follows:

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

Section 25.2518–2 is also issued under 26 U. S. C. 2518 (b). * * *

Par. 6. Section 25.2511–1 is amended as follows:

1. In paragraph (c)(l), the fourth sentence is revised.

2. A new paragraph (c)(3) is added.

The additions and revisions read as follows: 25. 2511–1 Transfers in asneral.

* * * * *

(c)(l) * * * However, in the case of a transfer creating an interest in property (within the meaning of 25.2518–2(c) (3) and (c) (4)) made after December 31, 1976, this paragraph (c)(l) shall not apply to the donee if, as a result of a qualified disclaimer by the donee, the interest passes to a different donee. * * *

* * * * *

(3) The fourth sentence of paragraph (c)(l) of this section is applicable for transfers creating an interest to be disclaimed made on or after December 31, 1997.

* * * * *

Par. 7. Section 25.2514–3 is amended as follows:

1. Paragraph (c) (5) is amended by revising the first sentence and adding a new sentence after the first sentence.

2. A new paragraph (c)(7) is added.

The additions and revisions read as follows:

§425.2514–3 Powers of appointment created after October 21. 1942.

* * * * *

(c) * * *

(5) * * * A disclaimer or renunciation of a general power of appointment created in a transfer made after December 31, 1976, is not considered a release of the power for gift tax purposes if the disclaimer or renunciation is a qualified disclaimer as described in section 2518 and the corresponding regulations. For rules relating to when a transfer creating the power occurs, see §25.2518–2(c) (3) . * * *

* * * * *

(7) The first and second sentences of paragraph (c)(5) of this section are applicable for transfers creating the power to be disclaimed made on or after December 31, 1997.

* * * * *

Par. 8. Section 25.2518–1 is amended as follows:

1. Paragraph (a)(l) is revi ;ed.

2. In paragraph (a)(2), the last three sentences of the example are removed and four new sentences are added in their place.

3. A new paragraph (a)(3) is added.

The additions and revisions read as follows:

§425.2518–1 Oualified disclaimers of property: In general.

(a) * * * (1) In aeneral. The rules described in this section, §25. 2518–2, and §25. 2518– 3 apply to the qualified disclaimer of an interest in property which is created in the person disclaiming by a transfer made after December 31, 1976. In general, a qualified disclaimer is an irrevocable and unqualified refusal to accept the ownership of an interest in property. For rules relating to the determination of when a transfer creating an interest occurs, see §25.2518–2(c)(3) and (4)

(2) * * *

Example. * * * The transfer creating the remainder interest in the trust occurred in 1968. See §25.2511–l(c)(2). Therefore, section 2518 does not apply to the disclaimer of the remainder interest because the transfer creating the interest was made prior to January 1, 1977. If, however, W had caused the gift to be incomplete by also retaining the power to designate the person or persons to receive the trust principal at death, and, as a result, no transfer (within the meaning of 2§5.2511–l(c)(2)) of the remainder interest was made at the time of the creation of the trust, section 2518 would apply to any disclaimer made after W's death with respect to an interest in the trust property.

(3) Paragraph (a)(l) of this section is applicable for transfers creating the interest to be disclaimed made on or after December 31, 1997.

* * * * *

Par. 9. Section 25.2518–2 is amended as follows:

1. The text of paragraph (c)(3) following the heading is redesignated as paragraph (c)(3)(i) and amended as follows:

a. In the first, eighth, and eleventh sentences, the word "taxable" is removed in each place it appears.

b. In the second and ninth sentences, the language "taxable transfer" is removed and "transfer creating an interest" is added in each place it appears.

c. In the third sentence the language "taxable transfers" is removed and "transfers creating an interest" is added.

d. The fourth, fifth, sixth, and seventh sentences are removed and five new sentences are added in their place.

2–3. A new paragraph (c) (3 (ii) is added.

4. Paragraph (c)(4) is revised.

5. In paragraph (c)(5), *Example (7)* is revised.

6. In paragraph (c)(5), *Example (8)* is removed.

7. In paragraph (c)(5), *Example (9)* is redesignated as *Example (12)* and is revised.

8. In paragraph (c)(5), *Example (10)* is redesignated as *Example (11)* and the first sentence is revised.

9. In paragraph (c)(5), new *Examples (8), (9), (10), (13),* and *(14)*, are added.

The additions and revisions read as follows:

625.2518–2 Requirements for a qualified disclaimer.

* * * * *

(c) * * * (3) *Transfer.* (i) * * * With respect to transfers made by a decedent at death or transfers that become irrevocable at death, the transfer creating the interest occurs on the date of the decedent's death, even if an estate tax is not imposed on the transfer. For example, a bequest of foreign-situs property by a nonresident alien decedent is regarded as transfer creating an interest in property even if the transfer would not be subject to estate tax. If there is a transfer creating an interest in property during the transferor's lifetime and such interest is later included in the transferor's gross estate for estate tax purposes (or would have been included if such interest were subject to estate tax), the 9-month period for making the qualified disclaimer is determined with reference to the earlier transfer creating the interest. In the case of a general power of appointment, the holder of the power has a 9-month period after the transfer creating the power in which to disclaim. If a person to whom any interest in property passes by reason of the exercise, release, or lapse of a general power desires to make a qualified disclaimer, the disclaimer must be made within a 9-month period after the exercise, release, or lapse regardless of whether the exercise, release, or lapse is subject to estate or gift tax. * * *

(ii) Sentences 1 through 10 and 12 of paragraph (c)(3)(i) of this section are applicable for transfers creating the interest to be disclaimed made on or after December 31, 1997.

(4) *Joint property*—(i) *Interests in joint tenancy with right of survivorship or tenancies by the entirety.* Except as provided in paragraph (c)(4)(iii) of this section (with respect to joint bank, brokerage, and other investment accounts), in the case of an interest in a joint tenancy with right of survivorship or a tenancy by the entirety, a qualified disclaimer of the interest to which the disclaimant succeeds upon creation of the tenancy must be made no later than 9 months after the creation of the tenancy regardless of whether such interest can be unilaterally severed under local law. A qualified disclaimer of the survivorship interest to which the survivor succeeds by operation of law upon the death of the first joint tenant to die must be made no later than 9 months after the death of the first joint tenant to die regardless of whether such interest can be unilaterally severed under local law and, except as provided in paragraph (c)(4)(ii) of this section (with respect to certain tenancies created on or after July 14, 1988), such interest is deemed to be a one-half interest in the property. (See, however, section 2518(b)(2)(B) for a special rule in the case of disclaimers by persons under age 21.) This is the case regardless of the portion of the property attributable to consideration furnished by the disclaimant and regardless of the portion of the property that is included in the decedent's gross estate under section 2040 and regardless of whether the interest can be unilaterally severed under local law. See paragraph (c)(5), Examples (*7*) and (*8*), of this section.

(ii) *Certain tenancies in real property between spouses created on or after July 14. 1988.* In the case of a joint tenancy between spouses or a tenancy by the entirety in real property created on or after July 14, 1988, to which section 2523(i)(3) applies (relating to the creation of a tenancy where the spouse of the donor is not a United States citizen), the surviving spouse may disclaim any portion of the joint interest that is includible in the decedent's gross estate under section 2040. See paragraph (c)(5), *Example (9)*, of this section.

(iii) *Special rule for joint bank, brokerege, and other investment accounts (e.g., accounts held at mutual funds) established between spouses or between persons other than husband and wife.* In the case of a transfer to a joint bank, brokerage, or other investment account (e.g., an account held at a mutual fund), if a transferor may unilaterally regain the transferor's own contributions to the account without the consent of the other cotenant, such that the transfer is not a completed gift under §25.2511–l(h)(4), the transfer creating the survivor's interest in the decedent's share of the account occurs on the death of the deceased cotenant. Accordingly, if a surviving joint tenant desires to make a qualified disclaimer with respect to funds contributed by a deceased cotenant, the disclaimer must be made within 9 months of the cotenant's death. The surviving joint tenant may not disclaim any portion of the joint account attributable to consideration furnished by that surviving joint tenant. See paragraph (c)(5), *Examples (12), (13)*, and (*14*), of this section, regarding the treatment of disclaimed interests under sections 2518, 2033 and 2040.

(iv) *Effective date.* This paragraph (c)(4) is applicable for disclaimers made on or after December 31, 1997.

(5) *Examples.* * * *

* * * * *

Example (7). On February 1, 1990, A purchased real property with A's funds. Title to the property was conveyed to "A and B, as joint tenants with right b' survivorship." Under applicable state law, the joint interest is unilaterally severable by either tenant. B dies on May 1, 1998, and is survived by A. On January 1, 1999, A disclaims the one-half survivorship interest in the property to which A succeeds as a result of B's death. Assuming that the other requirements of section 2518(b) are satisfied, A has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by A upon the creation of the tenancy, which may not be disclaimed by A). The result is the same whether or not A and B are married and regardless of the proportion of consideration furnished by A and B in purchasing the property.

Example (8). Assume the iame facts as in *Example (7)* except that A and B are married and title to the property was conveyed to "A and B, as tenants by the entirety." Under applicable state law, the tenancy cannot be unilaterally severed by either tenant. Assuming that the other requirements of section 2518(b) are satisfied, A has made a qualified disclaimer of the one-half survivorship interest (but not the interest retained by A upon the creation of the tenancy, which may not be disclaimed by A). The result is the same regardless of the proportion of consideration furnished by A and B in purchasing the property.

Example (9). On March 1, 1989, H and W purchase a tract of vacant land which is conveyed to them as tenants by the entirety. The entire consideration is paid by H. W is not a United States citizen. H

d es on June 1, 1998. W can disclaim the entire joint interest because this is the interest includible in H's gross estate under section 2040(a). Assuming that W's disclaimer is received by the executor of H's estate no later than 9 months after June 1, 1998, and the other requirements of section 2518(b) are satisfied, W's disclaimer of the property would be a qualified disclaimer. The result would be the same if the property was held in joint tenancy with right of survivorship that was unilaterally severable under local law.

Example (10). In 1986, pouses A and B purchased a personal residence taking title as tenants by the entirety. B dies on July 10, 1998. A wishes to disclaim the one-half undivided interest to which A would succeed by right of survivorship. If A makes the disclaimer, the propery interest would pass under B's will to their child C. C, an adult, and A resided in the residence at B's death and will continue to reside there in the future. A continues to own a one-half undivided interest in the property. Assuming that the other requirements of section 2518(b) are satisfied, A may make a qualified disclaimer with respect to the one-half undivided survivorship interest in the residence if A delivers the written disclaimer to the personal representative of B's estate by April 10, 1999, since A is not deemed to have accepted the interest or any of its benefits prior to that time and A's occupancy of the residence after B's death is consistent with A's retained undivided ownership interest. The result would be the same if property was held in joint tenancy with right of survivorship that was unilaterally severable under local law.

Example (11). H and W, husband and wife, reside in state X, a community property state. * * *

Example (12). On July 1, 1990, A opens a bank account that is held jointly with B, A's spouse, and transfers $50,000 of A's money to the account. A and B are United States citizens. A can regain the entire account without B's consent, such that the transfer is not a completed gift under §25.2511–l(h)(4). A dies on August 15, 1998, and B disclaims the entire amount in the bank account on October 15, 1998. Assuming that the remaining requirements of section 2518(b) are satisfied, B made a qualified disclaimer under section 2518 (a) because the disclaimer was made within 9 months after A's death at which time B had succeeded to full dominion and control over the account. Under state law, B is treated as predeceasing A with respect to the disclaimed interest. The disclaimed account balance passes through A's probate estate and is no longer joint property includible in A's gross estate under section 2040.The entire account is, instead, includible in A's gross estate und~er section 2033. The result would be the same if A and B were not married.

Example (13). The facts ire the same as *Example (12),* except that B, rather than A, dies on August 15, 1998. A may not make a qualified disclaimer with respect to any of the funds in the bank account, because A furnished the funds for the entire account and A did not relinq ish dominion and control over the funds. .

Example (14). The fact s are the same as *Example (12)*, except that B disclaims 40 F ercent of the funds in the account. Since, under state law, B is treated as predeceasing A with respect to the disclaimed interest, the 40 percent portion of the account balance that was disclaln~d passes as part of A's probate estate, and is no longer characterized as joint property. This 40 percent portion of the account balance is, therefore, includible in A's gross estate under section 2033. The remaining 60 percent of the account balance that was not disclaimed retains its character as joint property and, therefore, is includible in A's gross estate as provide in section 2040(b). Therefore, 30 percent (1/2 × 60 percent) of the account balance is includible in A's gross estate under section 2040(b), and a total of 70 percent of the aggregate account balance is includible in A's gross estate. If A and B were not married, then the 40 percent portion of the account subject to the disclaimer would be includible in A's gross estate as provided in section 2033 and the 60 percent portion of the account not subject to the disclaimer would be includible in A's gross estate as provided in section 2040(a), because A furnished all of the funds with respect to the account.

* * * * *

Michael P. Dolan,
Deputy Commissioner of Internal Revenue.

Approved December 10, 1997.

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

(Filed by the Office of the Federal Register on December 30, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 31, 1997, 62 F.R. 68183)

Section 2519.—Dispositions of Certain Life Estates

26 CFR 25.2519–1: Dispositions of certain life estates.
(Also sections 2044; 2056; 2511; 2512; 20.2044–1; 20.2056(b)–7; 25.2511–1; 25.2512–8)

Disposition of qualifying income interest. If a surviving spouse acquires the remainder interest in a trust subject to a QTIP election under section 2056(b)(7) of the Code in connection with the transfer by the surviving spouse of property or cash to the holder of the remainder interest, the surviving spouse makes a gift under sections 2511, 2512, and 2519 of the Code.

Rev. Rul. 98–8

ISSUE

What are the gift tax consequences to the surviving spouse of the acquisition by the surviving spouse of the remainder interest in a trust subject to a qualified terminable interest property (QTIP) election under § 2056(b)(7) of the Internal Revenue Code?

FACTS

The decedent, *D*, died in 1993 survived by *S*, *D*'s spouse. Under the terms of *D*'s will, a trust (the QTIP Trust) was established under which S was to receive all of the trust income, payable at least annually, for *S*'s life. On *S*'s death, the remainder was to be distributed outright to *C*, *D*'s adult child. *S* was not given a general power of appointment over the trust property.

On the federal estate tax return filed for *D*'s estate, the executor made an election under § 2056(b)(7) to treat the trust property as QTIP, and a marital deduction was allowed to *D*'s estate for the value of the property passing from *D* to the QTIP Trust.

Subsequently, *S*, *C*, and the trustee of the QTIP Trust entered into the following transaction: (1) *S* acquired *C*'s remainder interest in the QTIP Trust; (2) *S* gave *C* a promissory note in the face amount of x dollars (the value of the remainder interest) for the remainder interest; (3) the trustee distributed all of the QTIP Trust assets (having a value of $x + y$ dollars) to *S*; and (4) *S* thereupon paid x dollars from those assets to *C* in satisfaction of the promissory note.

At the conclusion of the transaction, the QTIP Trust was terminated; *S* held QTIP Trust assets having a value of y dollars (which was equal to the value of *S*'s life interest in the trust); and *C* held assets having a value of x dollars (which was equal to the value of the remainder interest in the trust). *S* contended that the transaction was not subject to gift tax because *S* received full and adequate consideration (the x dollar remainder interest in the QTIP Trust) in exchange for the x dollar promissory note given by *S* TO *C*.

LAW AND ANALYSIS

Section 2044(a) provides that the value of the gross estate includes the value of any property described in § 2044(b) in which the decedent had a qualifying income interest for life. Section 2044(b) provides that § 2044 applies to any property if a deduction was allowed with respect to the transfer of the property to the decedent under § 2056(b)(7).

Section 2056(a) provides that the value of the taxable estate is, except as limited

by § 2056(b), determined by deducting from the value of the gross estate an amount equal to the value of any interest in property that passes or has passed from the decedent to the surviving spouse.

Under § 2056(b)(1), if an interest passing to the surviving spouse will terminate, no deduction is allowed with respect to such interest if, after termination of the spouse's interest, an interest in the property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than the surviving spouse (or the estate of such spouse).

Section 2056(b)(7)(A) provides that qualified terminable interest property, for purposes of § 2056(a), is treated as passing to the surviving spouse, and no part of such property is treated as passing to any person other than the surviving spouse. In general, qualified terminable interest property is property in which the spouse receives a qualifying income interest for life,and with respect to which the executor makes an election to treat the property as QTIP.

Section 2511(a) provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2512(b) provides that where property is transferred for less than an adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration is deemed a gift.

Section 2519(a) provides that any disposition of all or part of a qualifying income interest for life in any property to which the section applies is treated as a transfer of all interests in the property other than the qualifying income interest. Section 2519(b) provides that the section applies to any property if a deduction was allowed with respect to the transfer of such property to the donor under § 2056(b)(7).

The estate tax marital deduction provisions are intended to provide a special tax benefit that allows property to pass to the surviving spouse without the decedent's estate paying tax on its value. Tax is deferred on the transfer until the surviving spouse either dies or makes a lifetime disposition of the property. Under either circumstance, a transfer (estate or gift) tax is paid. United States v. Stapf, 375 U.S. 118, 128 (1963), 1964-1 (Part 1) C.B. 535, 537; Estate of Clayton v. Commissioner, 976 F.2d 1486, 1491 (5th Cir. 1992); *Estate of Letts v.Commissioner,* 109 T.C. 290 (1997), ("It is a basic policy of the marital deduction that property that passes untaxed from a predeceasing spouse to a surviving spouse is included in the estate of the surviving spouse.")

The statutory scheme of the QTIP provisions is consistent with this congressional intent. Thus, a marital deduction is allowed under § 2056(b)(7) for property passing from a decedent to a QTIP trust in which the surviving spouse possesses a lifetime income interest. Sections 2519 and 2044 act to defer the taxable event on the marital deduction property only so long as the surviving spouse continues to hold the lifetime income interest.

Under § 2519, if a surviving spouse disposes of any part of the qualifying income interest, the spouse is treated as making a gift of the remainder interest in the underlying property (i.e., all interests in the property other than the income interest). Correspondingly, under § 2511, the disposition of the income interest by the spouse is treated as a gift, to the extent the income interest is transferred to another for less than adequate consideration.

The term "disposition," as used in § 2519, applies broadly to circumstances in which the surviving spouse's right to receive the income is relinquished or otherwise terminated, by whatever means. See H. Rep. No. 201, 97th Cong., 1st Sess. 161 (1981) that states:

> The bill provides that property subject to a [QTIP election] will be subject to transfer taxes at the earlier of (1) the date on which the spouse disposes (either by gift, sale, or otherwise) of all or part of the qualifying income interest, or (2) upon the spouse's death.

A commutation, which is a proportionate division of trust property between the life beneficiary and remainderman based on the respective values of their interests is, in the context of a QTIP trust, a taxable disposition by the spouse of the qualifying income interest, resulting in a gift under § 2519 of the value of the remainder interest. The commutation of the spouse's income interest in the QTIP trust is essentially a sale of the income interest by the spouse to the trustee (or the remainderman) in exchange for an amount equal to the value of the income interest. Sales and commutations are expressly characterized as dispositions in the applicable legislative history and regulations. Section 25.2519–1(g), Example 2 (illustrating that the sale by the spouse of the spouse's income interest to the trust remaindermen is a disposition of the income interest); § 25.2519–1(f) providing that "[T]he sale of qualified terminable interest property, followed by the payment to the donee-spouse of a portion of the proceeds equal to the value of the donee-spouse's income interest, is considered a disposition of the qualifying income interest". *See also, Estate of Novotny v. Commissioner,* 93 T.C. 12 (1989), in which the surviving spouse and remainderman divided the sale proceeds of QTIP property proportionately on the basis of the respective values of their interests; the court indicated that the commutation constituted a disposition by the spouse of the income interest for purposes of § 2519 and was thus subject to gift tax.

There is little distinction between the sale and commutation transactions treated as dispositions in the regulations and the transaction presented here, where *S* acquired the remainder interest. In both cases, after the transaction the spouse's income interest in the trust is terminated and the spouse receives outright ownership of property having a net value equal to the value of the spouse's income interest. Similarly, the remainderman receives ownership of property equal in value to the remainder interest. Thus, the transaction in the instant case essentially effectuates a commutation of *S*'s income interest in the trust, a transaction that is a disposition of *S*'s income interest under § 2519. Therefore, under § 2519, *S* is regarded as making a gift of *x* dollars, the value of the remainder interest in the QTIP Trust. Section 25.2519–1(f).

This conclusion that S has made a gift is also supported by an additional analysis. *S* acquired an asset (the remainder interest in the QTIP Trust) that is already subject to inclusion in *S*'s transfer tax base under § 2044. In analogous situations, the courts have recognized that the receipt of an asset that does not effectively increase the value of the recipient's gross estate does not constitute adequate consideration for purposes of the gift and

estate tax. *See Commissioner v. Wemyss,* 324 U.S. 303, 307 (1945), 1945 C.B. 416, ("The section taxing as gifts transfers that are not made for `adequate and full [money] consideration' aims to reach those transfers which are withdrawn from the donor's estate.")

A companion case to *Commissioner v. Wemyss, Merrill v. Fahs,* 324 U.S. 308 (1945), 1945 C.B. 418, and the cases that preceded it, involved situations where *A*, an individual, transferred property to *B*, A's spouse (or future spouse), in exchange for *B*'s relinquishment of marital rights in A's property. The Court held that *B*'s relinquishment of the marital rights did not constitute adequate and full consideration for A's transfer because the assets subject to the marital rights were already includible in *A*'s taxable estate. The property subject to dower and marital rights is clearly included in the gross estate of the property owner. Thus, to conclude that the relinquishment of dower and marital rights by the spouse of the property owner constituted adequate and full consideration for a transfer by the property owner for gift tax purposes would effectively subvert the legislative intent and statutory scheme of the gift tax provisions. *Merrill v. Fahs,* at 311–312. *See also, Commissioner v. Bristol,* 121 F.2d 129, 136 (1st Cir. 1941).

Likewise, in the present situation, property subject to the QTIP election was intended to be subject to either gift or estate tax. *S*'s receipt of the remainder interest does not increase the value of *S*'s taxable estate because that property is already subject to inclusion in *S*'s taxable estate under § 2044. Rather, *S*'s issuance of the note results in a depletion of *S*'s taxable estate that is not offset by *S*'s receipt of the remainder interest. Thus, for estate and gift tax purposes, *S*'s receipt of the remainder interest cannot constitute adequate and full consideration under § 2512 for the promissory note transferred by *S* to *C*. As was the case in M*errill v. Fahs,* any other result would subvert the legislative intent and statutory scheme underlying § 2056(b)(7). Therefore, under § 2511, *S* has made a gift to *C* equal to the value of the promissory note S gave to *C*.

In addition, a gift tax would be imposed under the above alternative rationales even if *S* acquired only a portion of *C*'s remainder interest; *e.g., S* acquired 60 percent of *C*'s remainder interest. If, under applicable state law, such a transaction results in a partial termination of the trust, *S* would be treated as disposing of part of *S*'s income interest in the trust, and the commutation analysis would apply. *See, e.g., Restatement (Second) of Trusts* § 340(2) (1959). *See also,* § 25.2519–1(g), Example 4, (illustrating the estate and gift tax consequences of the disposition of a portion of the spouse's income interest). If the trust does not terminate, *S* would nonetheless be treated as making a transfer under §§ 2511 and 2512 for less than adequate and full consideration to the extent of the value of the property or cash *S* transfers in exchange for the partial remainder interest.

Further, the conclusion of this revenue ruling would be the same if *S* transferred to *C* property or cash rather than the promissory note. The economic effect of the transaction is identical, regardless whether *S* uses *S*'s own funds to finance the transaction or gives a promissory note and discharges the note using some of the QTIP Trust assets received in the transaction. Thus, the result is the same for transfer tax purposes.

HOLDING

If a surviving spouse acquires the remainder interest in a trust subject to a QTIP election under § 2056(b)(7) in connection with the transfer by the surviving spouse of property or cash to the holder of the remainder interest, the surviving spouse makes a gift both under § 2519 and under §§ 2511 and 2512. The amount of the gift is equal to the greater of (i) the value of the remainder interest (pursuant to § 2519), or (ii) the value of the property or cash transferred to the holder of the remainder interest (pursuant to §§ 2511 and 2512).

DRAFTING INFORMATION

The principal author of this revenue ruling is Deborah Ryan of the office of Assistant Chief Counsel (Passthroughs and Special Industries. For further information regarding this revenue ruling contact Ms. Ryan on (202) 622-3090 (not a toll-free call).

Section 2702.—Special Valuation Rules in Case of Transfers of Interest in Trusts

26 CFR 25.2702–5: Personal residence trusts.

T.D. 8743

DEPARTMENT OF THE TREASURY
Internal Revenue Service
26 CFR Parts 25 and 602

Sale of Residence From Qualified Personal Residence Trust

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations

SUMMARY: This document contains final regulations permitting the reformation of a personal residence trust or a qualified personal residence trust in order to comply with the applicable requirements for such trusts. The final regulations also provide that the governing instruments of such trusts must prohibit the sale of a residence held in the trust to the grantor of the trust, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse.

DATES: The regulations are effective December 23, 1997.

FOR FURTHER INFORMATION CONTACT: Lane Damazo (202) 622-3090 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

Paperwork Reduction Act

The collection of information contained in these final regulations has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1485. Responses to this collection of information are required in order to ensure the proper collection of the gift tax.

An agency may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection of information displays a valid control number.

The estimated annual burden per respondent/recordkeeper varies from 3 hours to 3.25 hours, depending on individual circumstances, with an estimated average of 3.1 hours.

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

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

On April 16, 1996, the IRS published in the **Federal Register** a notice of proposed rulemaking (formerly PS–004–96) at 61 FR 16623. The IRS received written and oral comments on the proposed regulations and held a public hearing on July 24, 1996. This document adopts final regulations with respect to this notice of proposed rulemaking.

Comments with respect to §25.2702–5(a)(2) indicated that the procedure permitting reformation of trust instruments will be helpful to taxpayers and practitioners. It was suggested that an additional reformation period be made available for trusts for which the gift tax return due date had passed before the regulations became effective. Accordingly, under the final regulations, the trustees of trusts created before January 1, 1997, are granted a 90-day period after these regulations become final in which to reform the trust.

Some of the comments concerning the amendments to §25.2702–5(b) and (c) agreed that the restrictions in the proposed regulations on the sale of the personal residence after the termination of the grantor's retained interest in a personal residence trust or a qualified personal residence trust further the intent of Congress in enacting section 2702(a)(3)(A)(ii). Other comments stated that the restrictions were not supported by the statute. Treasury and the IRS continue to believe that these regulations are consistent with the intent of Congress and carry out the purpose of the personal residence exception to section 2702.

Other comments suggested that the final regulations should contain an exception permitting the sale of the residence to the grantor if the need arises. Treasury and the IRS believe, however, that a rule of this nature is not necessary, since a grantor may lease the residence after the retained term from a trust or individual to which the residence passes after the expiration of the initial term. The right to lease the residence may be expressly set forth in the trust document creating the personal residence trust. If the residence is leased for its fair market value rental, the grantor will not retain the economic benefit of the property for purposes of section 2036(a), since the grantor will be paying adequate consideration for the use of the property. However, if the residence is leased from a trust that is a grantor trust with respect to the grantor, the IRS under some circumstances may contend that the grantor has retained the economic benefit of the property.

Commentators raised a concern that because the regulations prohibit the transfer of the residence to the grantor, or the grantor's spouse, etc., the trust could not provide for a reversionary interest or a testamentary power of disposition, taking effect at the grantor's death prior to the expiration of the trust term, nor could the trust provide for a remainder interest in fee for the grantor's spouse (e.g., remainder outright to spouse, or remainder to child, but if child predeceases termination of the trust, then to spouse.) The final regulations permit dispositions to the spouse.

Finally, commentators objected to the statement in the preamble to the proposed regulations to the effect that if the IRS finds a pre-effective date trust to be inconsistent with the purposes of section 2702, the IRS, by established legal doctrines, may treat the trust as non-qualifying. Treasury and the IRS wish to clarify that the IRS will apply these regulations only to post-effective date trusts. Nevertheless, Treasury and the IRS have the authority to apply established legal doctrines to disqualify a pre-effective date trust in cases where the statutory purpose has clearly been violated.

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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and, because these regulations do not impose on small entities, a collection of information requirement, the Regulatory Flexibility Act (5 U.S.C. chapter 6), does not apply. Therefore, a Regulatory Flexibility Analysis is not required. Pursuant to section 7805(f) of the Internal Revenue Code, the Notice of Proposed Rulemaking preceding these regulations was submitted to the Small Business Administration for comment on their impact on small business.

Drafting Information

The principal author of these regulations is Dale Carlton, Office of the Chief Counsel, IRS. Other personnel from the IRS and Treasury Department participated in their development.

* * * * *

Adoption of Amendments to the Regulations

Accordingly, 26 CFR part 25 is amended as follows:

PART 25—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Paragraph 1. The authority citation for part 25 continues to read in part as follows:

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

Par. 2. Section 25.2702-5 is amended as follows:

1. Paragraph (a) heading and text are redesignated as paragraph (a)(1) heading and text and paragraph (a)(2) is added.

2. In paragraph (b)(1), five sentences are added after the third sentence.

3. Paragraph (c)(5)(ii)(C) is revised.

4. Paragraph (c)(9) is added.

The additions and revisions read as follows:

§25.2702–5 Personal residence trusts.

(a) * * *

(2) *Modification of trust.* A trust that does not comply with one or more of the regulatory requirements under paragraph

(b) or (c) of this section will, nonetheless, be treated as satisfying these requirements if the trust is modified, by judicial reformation (or nonjudicial reformation if effective under state law), to comply with the requirements. In the case of a trust created after December 31, 1996, the reformation must be commenced within 90 days after the due date (including extensions) for the filing of the gift tax return reporting the transfer of the residence under section 6075 and must be completed within a reasonable time after commencement. If the reformation is not completed by the due date (including extensions) for filing the gift tax return, the grantor or grantor's spouse must attach a statement to the gift tax return stating that the reformation has been commenced or will be commenced within the 90-day period. In the case of a trust created before January 1, 1997, the reformation must be commenced within 90 days after December 23, 1997, and must be completed within a reasonable time after commencement.

(b) * * * (1) * * * In addition, the trust does not meet the requirements of this section unless the governing instrument prohibits the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse, at any time after the original duration of the term interest during which the trust is a grantor trust. For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the original duration of the term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the original duration of the term interest, this paragraph (b)(1) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (b)(1) does not apply to any outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the original duration of the term interest pursuant to the express terms of the trust. For purposes of this paragraph (b)(1), a grantor trust is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and control is defined in §25.2701–2(b)(5)(ii) and (iii). * * *

* * * * *

(c) * * *

(5) * * *

(ii) * * *

(C) *Sale proceeds.* The governing instrument may permit the sale of the residence (except as set forth in paragraph (c)(9) of this section) and may permit the trust to hold proceeds from the sale of the residence, in a separate account.

* * * * *

(9) *Sale of residence to grantor, grantor's spouse, or entity controlled by grantor or grantor's spouse.* The governing instrument must prohibit the trust from selling or transferring the residence, directly or indirectly, to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse during the retained term interest of the trust, or at any time after the retained term interest that the trust is a grantor trust. For purposes of the preceding sentence, a sale or transfer to another grantor trust of the grantor or the grantor's spouse is considered a sale or transfer to the grantor or the grantor's spouse; however, a distribution (for no consideration) upon or after the expiration of the retained term interest to another grantor trust of the grantor or the grantor's spouse pursuant to the express terms of the trust will not be considered a sale or transfer to the grantor or the grantor's spouse if such other grantor trust prohibits the sale or transfer of the property to the grantor, the grantor's spouse, or an entity controlled by the grantor or the grantor's spouse. In the event the grantor dies prior to the expiration of the retained term interest, this paragraph (c)(9) does not apply to the distribution (for no consideration) of the residence to any person (including the grantor's estate) pursuant to the express terms of the trust or pursuant to the exercise of a power retained by the grantor under the terms of the trust. Further, this paragraph (c)(9) does not apply to an outright distribution (for no consideration) of the residence to the grantor's spouse after the expiration of the retained trust term pursuant to the express terms of the trust. For purposes of this paragraph (c)(9), a grantor trust is a trust treated as owned in whole or in part by the grantor or the grantor's spouse pursuant to sections 671 through 678, and control is defined in §25.2701–2(b)(5)(ii) and (iii).

* * * * *

Par. 3. Section 25.2702–7 is amended as follows:

1. The first sentence is revised.
2. A sentence is added at the end of the section.

The revision and addition read as follows:

§25.2702–7 Effective dates.

Except as provided in this section, §§25.2702–1 through 25.2702–6 apply as of January 28, 1992. * * * The fourth through eighth sentences of §25.2702-5(b)(1) and §25.2702–5(c)(9) apply with respect to trusts created after May 16, 1996.

PART 602—OMB CONTROL NUMBERS UNDER THE PAPERWORK REDUCTION ACT

Par. 4. The authority citation for part 602 continues to read as follows:

Authority: 26 U.S.C. 7805.

Par. 5. In §602.101, paragraph (c) is amended by adding an entry in numerical order to the table to read as follows:

§602.101 OMB Control numbers.

* * * * *

(c) * * *

CFR part or section where identified and described	Current OMB control No.
* * * * *	
25.2702–5	1545–1485
* * * * *	

Michael P. Dolan,
Acting Commissioner of Internal Revenue.

Approved December 4, 1997.

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

(Filed by the Office of the Federal Register on December 22, 1997, 8:45 a.m., and published in the issue of the Federal Register for December 23, 1997, 62 F.R. 66987)

Section 6033.—Returns by Exempt Organizations

This revenue procedure provides guidance to organizations exempt from taxation under § 501(a) of the Internal Revenue Code of 1986 on the application of amendments made to §§ 162(e) and 6033(e) by § 13222 of the Omnibus Budget Reconciliation Act of 1993. The revenue procedure identifies certain tax-exempt organizations that will be treated as satisfying the requirements of § 6033(e)(3). Those organizations will not be subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2). Procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3) are also provided. Rev. Proc. 95–35, 1995–2 C.B. 391, and Rev. Proc. 95–35A, 1995–2 C.B. 392, are superseded. See Rev. Proc. 98–19, page 30.

Section 6045.—Returns of Brokers

26 CFR 1.6045–4: Information reporting on real estate transactions with dates of closing on or after January 1, 1991.

Guidance is provided on the acceptable form of written assurances (certification) that a real estate reporting person must obtain from the seller of a principal residence to except such sale or exchange from the information reporting requirements for real estate transactions under section 6045(e)(5). See Rev. Proc. 98–20, page 32.

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also §§ 162, 501, and 6033)

Rev. Proc. 98–19

SECTION 1. PURPOSE

This Revenue Procedure provides guidance to organizations exempt from taxation under § 501(a) of the Internal Revenue Code of 1986 on certain exceptions from the reporting and notice requirements of § 6033(e)(1) and the tax imposed by § 6033(e)(2). The revenue procedure updates and supersedes Rev. Proc. 95-35, 1995–2 C.B. 391, as modified by Rev. Proc. 95–35A, 1995–2 C.B. 392.

Rev. Proc. 95–35 and Rev. Proc. 95–35A were issued pursuant to the Secretary's authority to relieve tax-exempt organizations from the burden of meeting the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2) where the organization establishes to the satisfaction of the Secretary that substantially all of the dues or other similar amounts paid by persons to such organization are not deductible without regard to § 162(e). Rev. Proc. 95–35 and Rev. Proc. 95–35A identify certain tax-exempt organizations that are treated as satisfying the requirements of § 6033(e)(3) and are thus not subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2). Procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3) are also provided.

In light of comments submitted in response to Rev. Proc. 95–35, the Service has determined that the requirements should be modified to further relieve the burden of § 6033(e)(1). This revenue procedure retains the requirements set out in Rev. Proc. 95–35, and Rev. Proc. 95–35A, with the modification that the amount of annual dues (or similar amounts) that may be received by organizations described in § 4.02 without becoming subject to the requirements of § 6033(e) is increased to $75 or less.

SEC. 2. BACKGROUND

Section 6033(e) imposes reporting and notice requirements on tax-exempt organizations (other than § 501(c)(3) organizations) that incur lobbying and political expenditures to which § 162(e) applies ("nondeductible lobbying expenditures"). Section 162(e) denies a deduction, otherwise allowable under § 162(a) as an ordinary and necessary trade or business expense, for certain lobbying and political expenditures. Section 162(e)(3) denies a deduction for the dues (or other similar amounts) paid to certain tax-exempt organizations to the extent that the organization, at the time the dues are assessed or paid, notifies the dues payer that the dues are allocable to nondeductible lobbying expenditures.

Section 6033(e)(1) requires a tax-exempt organization that pays or incurs nondeductible lobbying expenditures to notify its members, at the time the dues (or other similar amounts) are assessed or paid, of its reasonable estimate of the portion of the dues that is allocable to those expenditures. Section 6033(e)(1) does not, however, apply to tax-exempt organizations described in § 501(c)(3), or to organizations that establish to the satisfaction of the Secretary that substantially all the dues they receive are not deductible without regard to § 162(e). In addition, organizations whose lobbying and political expenditures consist solely of certain in-house expenditures for nondeductible lobbying and whose total such expenditures do not exceed $2,000 in a taxable year are not subject to the reporting and notice requirements of § 6033(e)(1).

Section 6033(e)(2)(A) provides that if a tax-exempt organization fails to provide the notices required by § 6033(e)(1), or if the notices underestimate the actual amount of dues allocable to nondeductible lobbying expenditures, the organization is subject to tax (at the highest rate imposed by § 11) on the aggregate amount of dues allocable to nondeductible lobbying expenditures paid during the taxable year that was not reported on the notices. However, § 6033(e)(2)(B) provides that if a tax would be imposed on the organization because its estimate of the nondeductible portion of the dues was less than the actual amount allocable to nondeductible lobbying expenditures, the Secretary may waive the tax if the organization agrees to increase the amount reasonably estimated to be nondeductible for the following taxable year by the amount of the underestimate.

Section 6033(e)(3) provides that § 6033(e)(1)(A) shall not apply to an exempt organization that establishes to the satisfaction of the Secretary that substantially all the dues or similar amounts paid by persons to the organization are not deductible without regard to § 162(e). The tax imposed by § 6033(e)(2)(A) only applies to organizations subject to the notice requirements of § 6033(e)(1)(A).

SEC. 3. SCOPE

This revenue procedure (i) sets forth specific circumstances in which certain tax-exempt organizations are treated as meeting the requirements of § 6033(e)(3), and (ii) provides guidance to other exempt organizations regarding how they may establish that they satisfy the requirements of § 6033(e)(3).

SEC. 4. APPLICATION

.01 *Exempt Organizations Automatically Excepted Under Section 6033(e)(3).* Organizations recognized by the Service as exempt from taxation under § 501(a), other than (i) social welfare organizations described in § 501(c)(4) that are not veterans organizations, (ii) agricultural and horticultural organizations described in § 501(c)(5), and (iii) organizations described in § 501(c)(6), are treated as satisfying the requirements of § 6033(e)(3).

.02 *Section 501(c)(4) Social Welfare Organizations and Section 501(c)(5) Agricultural and Horticultural Organizations.* Social welfare organizations recognized by the Service as exempt from taxation under § 501(c)(4) and agricultural and horticultural organizations recognized by the Service as exempt from taxation under § 501(c)(5) are treated as satisfying the requirements of § 6033(e)(3) if either (i) more than 90 percent of all annual dues (or similar amounts) are received from persons, families, or entities who each pay annual dues (or similar amounts) of $75 or less, or (ii) more than 90 percent of all annual dues (or similar amounts) are received from organizations described in § 501(c)(3), state governments, local governments, entities whose

income is exempt from tax under § 115, or organizations excepted under section 4.01 of this revenue procedure.

.03 *Section 501(c)(6) Organizations.* Organizations recognized by the Service as exempt from taxation under § 501(c)-(6) shall be treated as meeting the requirements of § 6033(e)(3) if more than 90 percent of all annual dues (or similar amounts) are received from organizations described in § 501(c)(3), state governments, local governments, entities whose income is exempt from tax under § 115, or organizations excepted under section 4.01 of this revenue procedure.

SEC. 5. DEFINITIONS AND PROCEDURES

.01 *Annual Dues (or Similar Amounts).* For purposes of this revenue procedure, the term "annual dues" means the amount an organization requires a person, family, or entity to pay to be recognized by the organization as a member for an annual period. For purposes of this revenue procedure, "similar amounts" includes, but is not limited to, voluntary payments made by persons, families, or entities, assessments made by the organization to cover basic operating costs, and special assessments imposed by the organization to conduct lobbying activities.

.02 *Member.* For purposes of this revenue procedure, "member" is used in its broadest sense and is not limited to persons with voting rights in the organization.

.03 *Treatment of Affiliated Organizations.* For purposes of this revenue procedure, if more than one organization described in §§ 501(c)(4), 501(c)(5), or 501(c)(6) share a name, charter, historic affiliation or similar characteristics and coordinate their activities, all such organizations shall be treated as parts of a single organization. Only dues (or similar amounts) paid by persons other than the organizations treated as being parts of the single organization shall be considered for purposes of applying this revenue procedure. All annual dues payments made by each person outside the organizational structure to any organization within the single organization are considered for purposes of applying this revenue procedure to be paid to the single organization for a single membership. If, under this revenue procedure, the single organization is considered to meet the requirements of § 6033(e)(3), then all the organizations that are treated as parts of the single organization are considered to meet the requirements of § 6033(e)(3). For purposes of this revenue procedure, if organizations within the affiliated structure are on different taxable years, the organizations may base their calculations of annual dues on any single reasonable taxable year.

.04 *Example of An Affiliated Organization.* A group of social welfare organizations, each of which is recognized by the Service as being described in § 501(c)(4), share a common name and work jointly to promote a single purpose. Each organization operates at either the national, state, or local level. Individuals and families that are interested in the purpose promoted by the organizations pay annual dues of $75 to one of the local organizations. The total amount of dues collected from individuals and families is $950x. Also, a number of corporations are members of the national organization and pay annual dues of $500 directly to it. The total amount of dues received from corporations is $50x. The organizations are linked by a structure that makes the local organizations members of the appropriate state organizations and of the national organization. Accordingly, each local organization transfers a portion of the dues it collects to the appropriate state organization and another portion to the national organization as dues. These transfer amounts are significantly greater than $75. Because the organizations share a name and coordinate their activities, they are treated as parts of a single organization for purposes of determining whether they satisfy the requirements of § 6033(e)(3). Therefore, only the dues (or similar amounts) paid by persons other than the organizations treated as being parts of the single organization are considered for purposes of applying this revenue procedure. The total amount of annual dues paid by individuals and families at the $75 level is more than 90 percent of all annual dues paid to both the local affiliated organizations by individuals and families, and to the national organization by corporations. Therefore, the single organization satisfies the requirements of § 6033(e)(3), which means that all the affiliated local and state organizations, and the national organization, are each considered to have satisfied the requirements of § 6033(e)(3).

.05 *Seventy-five Dollar Amount to be Indexed for Inflation.* The $75 amount for annual dues in section 4.02 will be increased for taxable years beginning after December 31, 1998, by a cost-of-living adjustment under § 1(f)(3) of the Code, rounded to the next highest dollar.

.06 *Establishing that an Organization is Described in § 6033(e)(3).* Any exempt organization that is not treated as satisfying the requirements of § 6033(e)(3) under section 4 of this revenue procedure may still establish that it satisfies the requirements of § 6033(e)(3) by: (i) maintaining records establishing that 90 percent or more of the annual dues (or similar amounts) paid to the organization are not deductible without regard to § 162(e), and (ii) notifying the Service that it is described in § 6033(e)(3) on any Form 990 (Return of Organization Exempt From Income Tax) that it is required to file. Unless an organization complies with both of the above requirements, it will not have established to the satisfaction of the Service that it meets the requirements of § 6033(e)(3). Additionally, an organization may request a private letter ruling that substantially all the annual dues (or similar amounts) paid to the organization are not deductible, either directly or indirectly, without regard to § 162(e). To receive a favorable private letter ruling, the organization must provide the Service with evidence establishing that 90 percent or more of all annual dues (or similar amounts) are not deductible, either directly or indirectly, without regard to § 162(e). If an organization receives a favorable private letter ruling, the Service will not contest the organization's entitlement to exemption under § 6033(e)(3) for a subsequent year so long as the character of the organization's membership is substantially similar to its membership at the time of the ruling. Ruling requests should be submitted to the Assistant Commissioner (Employee Plans and Exempt Organizations), Attention: CP:E:EO, Internal Revenue Service, P.O. Box 120, Ben Franklin Station, Washington, DC 20044, in accordance with Rev. Proc. 98–4, 1998–1 I.R.B. 113 (January 5, 1998) (or as revised).

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 95–35, 1995–2 C.B. 391, and Rev. Proc. 95–35A, 1995–2 C.B. 392, are superseded.

PAPERWORK REDUCTION ACT

The collection of information contained in this revenue procedure has been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1589.

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 OMB control number.

The collection of information in this revenue procedure is in section 5.06. This revenue procedure provides guidance to organizations exempt from taxation under § 501(a) of the Internal Revenue Code of 1986 on certain exceptions from the reporting and notice requirements of § 6033(e)(1) and the tax imposed by § 6033(e)(2). It identifies certain tax-exempt organizations that are treated as satisfying the requirements of § 6033(e)(3) and are thus not subject to the reporting and notice requirements of § 6033(e)(1) or the tax imposed by § 6033(e)(2), and provides procedures for other exempt organizations to establish that they satisfy the requirements of § 6033(e)(3). The information maintained by exempt organizations will be used in determining whether they meet the exception provided under § 6033(e)(3). The record retention and annual reporting are required to assure compliance with the requirements of § 6033(e). The likely respondents are social welfare organizations exempt under § 501(c)(4), agricultural and horticultural organizations exempt under 501(c)(5), and business leagues exempt under § 501(c)(6) that wish to establish that they receive substantially dues from members who do not claim a deduction for their dues payments under § 162, without regard to § 162(e).

The estimated total annual recordkeeping burden is 150,000 hours.

The estimated annual burden per organization varies from 1 hour to 100 hours, depending on individual circumstances, with an estimated average of 10 hours. The estimated number of organizations required to maintain records is 15,000.

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

DRAFTING INFORMATION

The principal author of this revenue procedure is Thomas J. Miller of the Exempt Organizations Division. For further information regarding this revenue procedure contact Mr. Miller on (202) 622-7867 (not a toll-free call).

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26 CFR 601.602: Tax forms and instructions.
(Also Part I, Section 6045; 1.6045-4; section 121)

Rev. Proc. 98–20

SECTION 1. PURPOSE

This revenue procedure sets forth the acceptable form of the written assurances (certification) that a real estate reporting person must obtain from the seller of a principal residence to except such sale or exchange from the information reporting requirements for real estate transactions under § 6045(e)(5) of the Internal Revenue Code.

SECTION 2. BACKGROUND

.01 Section 6045(e) and § 1.6045–4 of the Income Tax Regulations generally require a real estate reporting person (as defined in § 6045(e)(2) and § 1.6045–4) to file an information return regarding a real estate transaction and to furnish a payee statement to the seller regarding that transaction. The information return and statement must include the name, address, and taxpayer identification number (TIN) of the seller, and the gross proceeds of the real estate transaction. This information is reported on Form 1099-S, Proceeds From Real Estate Transactions.

.02 Section 312 of the Taxpayer Relief Act of 1997 (the Act), Pub. L. No. 105–34, 111 Stat. 788 (August 5, 1997), effective for sales or exchanges after May 6, 1997, amended § 6045(e) by adding a new paragraph (5), which excepts a sale or exchange of a residence from the § 6045(e) information reporting requirements if the seller provides the real estate reporting person with a certification setting forth certain written assurances, including an assurance that the residence is the seller's principal residence (within the meaning of § 121) and an assurance that the full amount of the gain on the sale or exchange of the principal residence is excludable from gross income under § 121.

.03 Section 312 of the Act also amended § 121 to provide new rules for the exclusion of gain on certain sales or exchanges of a principal residence. Section 121, as amended, provides that a taxpayer may exclude from gross income up to $250,000 of gain on the sale or exchange of a principal residence if certain conditions are met. In certain circumstances, a married individual filing a joint return for the taxable year of the sale or exchange may exclude from gross income up to $500,000 of gain. This exclusion also applies to the sale or exchange of stock held by a tenant-stockholder in a cooperative housing corporation (as defined in § 216) and may apply to the sale or exchange of a remainder interest in a principal residence if the taxpayer so elects.

SECTION 3. SCOPE

This revenue procedure applies to the information reporting requirements under § 6045(e) for a sale or exchange of a principal residence.

SECTION 4. SELLER CERTIFICATION

.01 To be excepted from the information reporting requirements in § 6045(e) on the sale or exchange of a residence (including stock in a cooperative housing corporation), the real estate reporting person must obtain from the seller a written certification, signed by the seller under penalties of perjury, that assurances (1) through (4) set forth in section 4.02 of this revenue procedure are true. For purposes of this certification, the term "seller" includes each owner of the residence that is sold or exchanged. Thus, if a residence has more than one owner, a real estate reporting person must either obtain a certification from each owner (whether married or not) or file an information return and furnish a payee statement for any owner that does not make the certification.

.02 The assurances are:

(1) The seller owned and used the residence as the seller's principal residence for periods aggregating 2 years or more during the 5-year period ending on the date of the sale or exchange of the residence.

(2) The seller has not sold or exchanged another principal residence during the 2-year period ending on the date of the sale or exchange of the residence (not taking into account any sale or exchange before May 7, 1997).

(3) No portion of the residence has been used for business or rental purposes by the seller (or the seller's spouse if the seller is married) after May 6, 1997.

(4) At least one of the following three statements applies:

The sale or exchange is of the entire residence for $250,000 or less.

OR

The seller is married, the sale or exchange is of the entire residence for $500,000 or less, and the gain on the sale or exchange of the entire residence is $250,000 or less.

OR

The seller is married, the sale or exchange is of the entire residence for $500,000 or less, and (a) the seller intends to file a joint return for the year of the sale or exchange, (b) the seller's spouse also used the residence as his or her principal residence for periods aggregating 2 years or more during the 5-year period ending on the date of the sale or exchange of the residence, and (c) the seller's spouse also has not sold or exchanged another principal residence during the 2-year period ending on the date of the sale or exchange of the residence (not taking into account any sale or exchange before May 7, 1997).

SECTION 5. FORMAT FOR MAKING SELLER CERTIFICATION

A sample certification form that may be used by a real estate reporting person to obtain the applicable assurances from the seller is provided in the Appendix of this revenue procedure. However, use of this sample certification form is not required. The requirements of the certification under § 6045(e)(5) will be met if the content and wording of a written certification provide the same information as required by section 4.02 of this revenue procedure.

SECTION 6. OBTAINING AND RETAINING SELLER CERTIFICATION

.01 *General rule.* Except as provided in section 6.02 of this revenue procedure, the real estate reporting person may obtain a certification at any time on or before January 31 of the year following the year of the sale or exchange of the residence. The certification must be retained by the real estate reporting person for 4 years after the year of the sale or exchange of the residence to which the certification applies.

.02 *Transition rule.* For a sale or exchange of a residence occurring after May 6, 1997 and on or before December 31, 1997, the real estate reporting person may obtain a certification at any time on or before February 28, 1998.

SECTION 7. PENALTIES

A real estate reporting person who relies on a certification made in compliance with this revenue procedure will not be liable for the penalties under § 6721 for failure to file an information return, or under § 6722 for failure to furnish a payee statement to the seller, unless the real estate reporting person has actual knowledge that any assurance is incorrect.

SECTION 8. COMMENTS INVITED

The Service requests comments on any additional guidance that may be needed under §§ 6045(e)(5) and 121. Comments should be submitted by April 30, 1998, to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, Attn: CC:DOM:CORP:R (IT&A Branch 2), Room 5226. Submissions may be hand-delivered between the hours of 8 a.m. and 5 p.m. to: Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC, Attn: CC:DOM:CORP:R (IT&A Branch 2), Room 5226. Alternatively, taxpayers may submit comments electronically at

http://www.irs.ustreas.gov/prod/tax regs/comments.html

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

SECTION 9. EFFECTIVE DATE

This revenue procedure is effective for sales or exchanges of a residence occurring after May 6, 1997.

SECTION 10. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545–1592.

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 OMB control number.

The collection of information in this revenue procedure is in sections 4 and 5 of this revenue procedure. This information is required to exempt a real estate reporting person from the requirement to file an information return and furnish a payee statement reporting the sale or exchange of a principal residence. The likely respondents are individual taxpayers who sell or exchange a principal residence and real estate businesses.

The estimated total annual reporting burden for respondents is 383,000 hours.

The estimated burden per respondent is 10 minutes. The estimated number of respondents is 2,300,000. The frequency of responses is on occasion.

The estimated total annual burden for recordkeepers is 37,500 hours.

The estimated annual burden per recordkeeper is 25 minutes. The estimated number of recordkeepers is 90,000.

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

DRAFTING INFORMATION

The principal author of this revenue procedure is Sharon Hester of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Hester at (202) 622-4920 (not a toll-free call).

APPENDIX

CERTIFICATION FOR NO INFORMATION REPORTING ON THE SALE OR EXCHANGE OF A PRINCIPAL RESIDENCE

This form may be completed by the seller of a principal residence. This information is necessary to determine whether the sale or exchange should be reported to the seller, and to the Internal Revenue Service on Form 1099-S, Proceeds From Real Estate Transactions. If the seller properly completes Parts I and III, and makes a "yes" response to assurances (1) through (4) in Part II, no information reporting to the seller or to the Service will be required for that seller. The term "seller" includes each owner of the residence that is sold or exchanged. Thus, if a residence has more than one owner, a real estate reporting person must either obtain a certification from each owner (whether married or not) or file an information return and furnish a payee statement for any owner that does not make the certification.

Part I. Seller Information

1. Name ____________________

2. Address or legal description (including city, state, and ZIP code) of residence being sold or exchanged

____

____

3. Taxpayer Identification Number (TIN) ____________________

Part II. Seller Assurances

Check "yes" or "no" for assurances (1) through (4).

Yes No

☐ ☐ (1) I owned and used the residence as my principal residence for periods aggregating 2 years or more during the 5-year period ending on the date of the sale or exchange of the residence.

☐ ☐ (2) I have not sold or exchanged another principal residence during the 2-year period ending on the date of the sale or exchange of the residence (not taking into account any sale or exchange before May 7, 1997).

☐ ☐ (3) No portion of the residence has been used for business or rental purposes by me (or my spouse if I am married) after May 6, 1997.

☐ ☐ (4) At least one of the following three statements applies:

The sale or exchange is of the entire residence for $250,000 or less.

OR

I am married, the sale or exchange is of the entire residence for $500,000 or less, and the gain on the sale or exchange of the entire residence is $250,000 or less.

OR

I am married, the sale or exchange is of the entire residence for $500,000 or less, and (a) I intend to file a joint return for the year of the sale or exchange, (b) my spouse also used the residence as his or her principal residence for periods aggregating 2 years or more during the 5-year period ending on the date of the sale or exchange of the residence, and (c) my spouse also has not sold or exchanged another principal residence during the 2-year period ending on the date of the sale or exchange of the residence (not taking into account any sale or exchange before May 7, 1997).

Part III. Seller Certification

Under penalties of perjury, I certify that all the above information is true as of the end of the day of the sale or exchange.

____________________ ____________________

Signature of Seller Date

Part IV. Items of General Interest

Announcement 98–9

Corrections are needed for the 1998 Circular E, Employer's Tax Guide (Publication 15). Paper copies of Circular E and copies downloaded from the IRS web site or bulletin board before January 9, 1998, contain errors.

The second paragraph under the heading "Family Employees" on page 7 should read:

> Payments for the services of a child under the age of 21 who works for his or her parent whether or not in a trade or business are not subject to Federal unemployment (FUTA) tax.

In addition, the Advance EIC Payment Tables contain errors (page 59 only). If these tables are used, some employees may receive slightly lower advance EIC payments than they are entitled to receive. However, because the errors create only small differences in advance EIC payments, employers are not required to correct payments already made or reprogram for the remainder of 1998.

A corrected Circular E has been posted to the IRS web site at www.irs.ustreas.gov. The tables in Circular A, Agricultural Employer's Tax Guide (Pub. 51), and in Notice 1036, Early Release Copies of Income Tax Withholding and Advance Earned Income Credit Payment Tables, are correct as originally issued.

Foundations Status of Certain Organizations

Announcement 98–10

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

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

Brighton Foundation, Inc., Muncie, IN
Camp Wanna-Be Inc., Vidalia, GA
Children and Families Inc., Baltimore, MD
Children Inc., Raleigh, NC
Children of Mine, Washington, DC
Childrens Advocacy Center Inc., Phoenix, AZ
Childrens Alternative Services Inc., Annapolis, MD
Childrens Center of Preston County Inc., Bruceton Mills, WV
Childrens Christmas Dream Fund Inc., St. Petersburg, FL
Circle C Child Development Center, Inc., Austin, TX
Circle of Hope Inc., Mableton, GA
Citizens Advocating Responsible Transportation, Houston, TX
Doris Humphrey Repertory Dance Company, Princeton, NJ
Doubletree Foundation Inc., Austin, TX
Douglas County Preservation Alliance Inc., Lawrence, KS
El Cid Historic Neighborhood, West Palm Beach, FL
El Paso Adult Day Care Service, El Paso, TX
El Paso Borderlands Cultural Center, El Paso, TX
El S O L Project Save Our Landscape Project, Kingsville, TX
El Shaddai Emmaus Community of Illiana Inc., Harmony, IN
Elephant Management USA Inc., Franksville, WI
Family Enrichment Center, Inc., Indianapolis, IN
Friends of Harris Park, Birmingham, AL
Great Promise, Austin, TX
Great River Foundation Inc., Natchez, MS
Greater Annapolis Public Safety Foundation Inc., Annapolis, MD
Greater Columbus Billy Graham Crusade, Columbus, OH
Greene County Child Abuse Prevention Council Inc., Solsberry, IN
Greene County Courthouse Preservation Society Inc., Paragould, AR
Greene County Education Foundation, Eutaw, AL
Grosse Pointe High School-Grosse Point South High School Alumni Association, Grosse Pointe, MI
Group for Affordable Housing, Roseville, MN
Grove City Football Supporters Inc., Grove City, OH
Guilford County Minority AIDS Task Force, Greensboro, NC
Hannah's House, Inc., Mishawaka, IN
Health Education Resources Network of Abilene Herna, Abilene, TX
Healthier People Network Inc., Decatur, GA
Heart of Chicago Association, Oak Brook, IL
Heart of Florida Via De Cristo, Winter Park, FL
Heart of Ohio Girls Softball Association, Richwood, OH
Heart of the Rockies Christian Conference, Salida, CO
Heart of the Rockies Singers, Breckenridge, CO
Hockey Unlimited Inc., Wausau, WI
Hohokam Tribe of Indians, Tucson, AZ
Holland Harbor Lighthouse Historical Commission, East Lansing, MI
Holland Home Health Services, Grand Rapids, MI
Holley Navarre Senior Association Inc., Navarre, FL
Holly Pride Committee, Holly, CO
Holy Rock Ministries Inc., Midwest City, OK
Holyland and Bible Faith Foundation, Washington, DC
Home Inc., Colfax, NC
Home of a Second Chance Incorporated, Indianapolis, IN
Jefferson Business Referrals Inc., New Orleans, LA
Jefferson County Tuberculosis Association Inc., Charles Town, WV
Jefferson Junior Wrestling Association Inc., JJWA, Kearneysville, WV
Jehovah Rapha Ministries, Starr, SC
Jehovah Rapha Missions, Athens, TN
Jemison-Van De Graaff Mansion Foundation, Tuscaloosa, AL
Jersey Light Horse Brigade Inc., Ringwood, NJ

Kansas-Laubach Literacy Action Inc., Arkansas City, KS
Kansas Nurses for Life Inc., Valley Center, KS
Karpenissi Inc., Charlotte, NC
Keep America Warm Inc., Tulsa, OK
Keep Michigan Beautiful Foundation, Bloomfield Hills, MI
Lakeshore Soccer League, Stevensville, MI
Lakeview Senior Citizens Center, Macon, MO
Lamar County Firefighters Association, Chicota, TX
Lamar Haven Inc., Fayette, AL
Lesbian Thesbians Inc., Durham, NC
Let God Arise Ministries Inc., Montgomery, AL
Levi Graham Henry III Scholarship Foundation Inc., Miami, FL
Levi Jordan Plantation Historical Society, Angleton, TX
Lorain County D.A.R.E. Officers Association Inc., Elyria, OH
Louisville Senior Citizens Inc., Louisville, NE
Love & Light Support Co. Inc., Kansas City, MO
Love-A-Lot Day Care Center Inc., Dahlonega, GA
Love Abounds House of Charity, Edgewater, FL
Love All-Serve All Inc., Tallahassee, FL
Love and Faith Support Sytems Inc., Chicago, IL
Maryland Womens Lacrosse Club Incorporated, Chattanooga, TN
Maryland Youth Corporation Inc., Owings Mills, MD
Masjidullah Economic Community Corporation of America-M.E.C.C.A., Philadelphia, PA
Massacre Canyon Inc., Palisade, NE
Masterbuilders Inc., Knoxville, TN
Mastering Life Ministries Inc., Hermitage, TN
Matthews Housing Corporation, Dallas, TX
Melbourne Beach Soccer Club Inc., Melbourne Beach, FL
Melchizedek Non-Profit Inc., Chicago, IL
Melody and Harmony Low Cost Housing, Far Hills, NJ
Metro Life Choices, Dearborn, MI
Metropolitan Community Housing Development Organization, Southfield, MI
Miami County Council on Aging, Bucyrus, KS
Miami Literature Depot Inc., Miami, FL
Miami Valley Council for Native Americans, Dayton, OH
Micro Enterprise Assistance Program, Pittsburgh, PA
Mid-Atlantic Marine Education Association, Williamsburg, VA
Mid-City Development Corporation, Detroit, MI
Morgan Resident Association Inc., Morgan, PA
Morris Hockey Association Inc., Morris, MN
Morton-Tulpehocken Civic Association, Philadelphia, PA
Mosswood Golf & Recreation Association, Monroe City, MO
Mothers Against Gangs-Evanston Inc., Evanston, IL
Ronald McDonald House Charities in Omaha Inc., Omaha, NE
Sophia Schnitman Educational Foundation Inc., East Windsor, NJ
Virginia Chapter of National Bureau of Missing Children Inc., Richmond, VA

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

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

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

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

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

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

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

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

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

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

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

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

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

Definition of Terms

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

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

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

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

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

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

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

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1986 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified* and *superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

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

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

Abbreviations

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

A—Individual.
Acq.—Acquiescence.
B—Individual.
BE—Beneficiary.
BK—Bank.
B.T.A.—Board of Tax Appeals.
C.—Individual.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
CI—City.
COOP—Cooperative.
Ct.D.—Court Decision.
CY—County.
D—Decedent.
DC—Dummy Corporation.
DE—Donee.
Del. Order—Delegation Order.
DISC—Domestic International Sales Corporation.
DR—Donor.
E—Estate.
EE—Employee.
E.O.—Executive Order.
ER—Employer.
ERISA—Employee Retirement Income Security Act.
EX—Executor.
F—Fiduciary.
FC—Foreign Country.
FICA—Federal Insurance Contribution Act.
FISC—Foreign International Sales Company.
FPH—Foreign Personal Holding Company.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
FX—Foreign Corporation.
G.C.M.—Chief Counsel's Memorandum.
GE—Grantee.
GP—General Partner.
GR—Grantor.
IC—Insurance Company.
I.R.B.—Internal Revenue Bulletin.
LE—Lessee.
LP—Limited Partner.
LR—Lessor.
M—Minor.
Nonacq.—Nonacquiescence.
O—Organization.
P—Parent Corporation.
PHC—Personal Holding Company.
PO—Possession of the U.S.
PR—Partner.
PRS—Partnership.
PTE—Prohibited Transaction Exemption.
Pub. L.—Public Law.
REIT—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Proc..—Revenue Ruling.
S—Subsidiary.
S.P.R.—Statements of Procedral Rules.
Stat.—Statutes at Large.
T—Target Corporation.
T.C.—Tax Court.
T.D.—Treasury Decision.
TFE—Transferee.
TFR—Transferor.
T.I.R.—Technical Information Release.
TP—Taxpayer.
TR—Trust.
TT—Trustee.
U.S.C.—United States Code.
X—Corporation.
Y—Corporation.
Z—Corporation.

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

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