

## **HIGHLIGHTS OF THIS ISSUE**

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

### **INCOME TAX**

#### **Rev. Rul. 2004-54, page 1024.**

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2004.

#### **T.D. 9125, page 1012.**

Final regulations under section 221 of the Code provide rules for the treatment of interest paid on a qualified education loan during the taxable year. The regulations clarify that qualified education interest includes capitalized interest and other amounts charged for the use or forbearance of money. The regulations also amend the transition period in the regulations under section 6050S to provide that information reporting is not required for loan origination fees and capitalized interest on loans made before September 1, 2004.

#### **T.D. 9126, page 1023.**

Final regulations under section 704 of the Code allow revaluations in connection with the grant of an interest in the partnership (other than a *de minimis* interest) as consideration for the provision of services to or for the benefit of the partnership.

#### **REG-140492-02, page 1031.**

Proposed regulations under section 142(a) of the Code define solid waste disposal facilities for purposes of exempt facility bonds. Generally, interest on a state or local bond is excluded from gross income. However, the exclusion does not apply to a private activity bond unless the bond is a qualified bond. A qualified bond includes an exempt facility bond that meets certain requirements. Exempt facility bonds include bonds for solid waste disposal facilities. A public hearing is scheduled for August 11, 2004.

### **EMPLOYEE PLANS**

#### **Notice 2004-40, page 1028.**

**Weighted average interest rate update; corporate bond indices; 30-year Treasury securities.** The weighted average interest rate for May 2004 and the resulting permissible range of interest rates used to calculate current liability and to determine the required contribution are set forth.

#### **Announcement 2004-51, page 1041.**

This announcement corrects an error in section V. of Announcement 2004-43, 2004-21 I.R.B. 955, and restates the section as corrected. Announcement 2004-43 corrected.

### **ADMINISTRATIVE**

#### **Rev. Rul. 2004-53, page 1026.**

**Clarification of scope of section 6103(a).** This ruling clarifies the fact that government employees who receive returns or return information pursuant to disclosures under section 6103(c), (k)(6), or (e) of the Code, other than section 6103(e)(1)(D)(iii) (relating to certain shareholders), are not subject to the disclosure restrictions of section 6103(a) with regard to the returns or return information received.

#### **Rev. Proc. 2004-35, page 1029.**

This procedure concerns automatic relief to file certain late shareholder consents to be an S corporation.

Announcements of Disbarments and Suspensions begin on page 1036.  
Finding Lists begin on page ii.



# The IRS Mission

Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by

applying the tax law with integrity and fairness to all.

## 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 are compiled 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 Other Related Items, 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.**

This part includes notices of proposed rulemakings, disbarment and suspension lists, and announcements.

The last 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 last Bulletin of each semiannual period.

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

## Section 42.—Low-Income Housing Credit

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

## Section 221.—Interest on Education Loans

26 CFR 1.221-1: Deduction for interest paid on qualified education loans after December 31, 2001.

### T.D. 9125

#### DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1

#### Deduction for Interest on Qualified Education Loans

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

**SUMMARY:** This document contains final regulations relating to the deduction under section 221 of the Internal Revenue Code (Code) for interest paid on qualified education loans. The final regulations reflect the enactment and amendment of section 221 by the Taxpayer Relief Act of 1997, the Internal Revenue Service Restructuring and Reform Act of 1998, the Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, and the Economic Growth and Tax Relief Reconciliation Act of 2001. This document also contains amendments to the final regulations under section 6050S relating to the information reporting requirements for interest payments received on qualified education loans. The final regulations affect taxpayers who pay interest on qualified education loans and payees who receive payments of interest on qualified education loans.

**DATES:** *Effective Date:* These final regulations are effective May 7, 2004.

*Applicability Date:* Section 1.221-1 is applicable to periods governed by section

221 as amended in 2001, which relates to interest paid on qualified education loans after December 31, 2001, and on or before December 31, 2010. Section 1.221-2 is applicable to interest due and paid on qualified education loans after January 21, 1999, but before January 1, 2002, and again after December 31, 2010. Taxpayers also may apply § 1.221-2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. The amendments to § 1.6050S-3 provide a transitional rule for certain interest payments with respect to qualified education loans made before September 1, 2004, and provide guidance applicable to qualified education loans made on or after that date.

FOR FURTHER INFORMATION CONTACT: Sean M. Dwyer at (202) 622-5020 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

#### Background

On January 21, 1999, the IRS published a notice of proposed rulemaking (REG-116826-97, 1999-1 C.B. 701) in the **Federal Register** (64 FR 3257) under section 221 of the Code. The notice of proposed rulemaking implemented section 202 of the Taxpayer Relief Act of 1997, Public Law 105-34 (111 Stat. 778), which added section 221 to the Code. The IRS received written, including electronic, comments responding to the proposed regulations. There were no requests for a public hearing and none was held.

Subsequent to the publication of the proposed regulations, section 412 of the Economic Growth and Tax Relief Reconciliation Act of 2001, Public Law 107-16 (115 Stat. 38) (2001 Act) amended section 221 by eliminating the 60-month limitation period and the restriction on deductions of interest a taxpayer pays during a period when the lender does not require payments. The 2001 Act also increased the income limitations relating to interest deductions under section 221 from \$55,000 (\$75,000 for married individuals filing jointly) to \$65,000 (\$130,000 for married individuals filing jointly) and the income

phase-out range from \$40,000-\$55,000 (\$60,000-\$75,000 for married individuals filing jointly) to \$50,000-\$65,000 (\$100,000-\$130,000 for married individuals filing jointly).

The 2001 Act amendments apply to interest paid on qualified education loans after December 31, 2001. Accordingly, the final regulations appear in two sections to reflect the law before and after the effective date of the 2001 Act. Section 1.221-1 is applicable to periods governed by section 221 as amended in 2001, which relates to interest paid on qualified education loans after December 31, 2001, and on or before December 31, 2010. Section 1.221-2 is applicable to interest due and paid on qualified education loans after January 21, 1999, but before January 1, 2002. Taxpayers also may apply § 1.221-2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. Unless the 2001 Act amendments are extended by future legislation, section 1.221-2 also will apply to interest due and paid on qualified education loans after December 31, 2010.

After consideration of all the comments, the proposed regulations under section 221 are adopted as amended by this Treasury decision.

On April 29, 2002, the IRS published final regulations (T.D. 8992, 2002-1 C.B. 981) in the **Federal Register** (67 FR 20901) under section 6050S relating to information reporting for interest payments received on qualified education loans. The Taxpayer Relief Act of 1997 added section 6050S to the Code, as well as section 221.

#### Explanation and Summary of Comments

Many of the comments concerned issues relating to the 60-month limitation period, which the 2001 Act eliminated. These comments are discussed in 7. and 8. below because the 60-month period continues to apply to interest on qualified education loans due and paid after December 31, 1997, but before January 1, 2002, and again after December 31, 2010.

## 1. Treatment of Capitalized Interest and Certain Fees

Several commentators discussed the treatment of capitalized interest, loan origination fees, late fees, and certain insurance fees. Courts have defined the term “interest,” for income tax purposes, as compensation paid for the use or forbearance of money. See, e.g., *Deputy v. Du Pont*, 308 U.S. 488 (1940). Consistent with this definition, the final regulations provide that capitalized interest is deductible as qualified education loan interest. Generally, fees, such as loan origination fees or late fees, are interest if the fees represent a charge for the use or forbearance of money. Therefore, if the fees represent compensation to the lender for the cost of specific services performed in connection with the borrower’s account, the fees are not interest for Federal income tax purposes. See Rev. Rul. 69-188, 1969-1 C.B. 54, amplified by Rev. Rul. 69-582, 1969-2 C.B. 29; see also, e.g., *Trivett v. Commissioner*, T.C. Memo. 1977-161, *aff’d on other grounds*, 611 F.2d 655 (6<sup>th</sup> Cir. 1979) (Tax Court found that certain fees, including insurance fees, were similar to payments for services rendered and not deductible as interest).

Some commentators expressed confusion about how to apply the rules in the proposed regulations for allocating payments to principal or interest. In response to these comments, the final regulations provide guidance on the treatment and allocation of such amounts. Under the final regulations, a payment generally first applies to interest that has accrued and remains unpaid as of the date the payment is due and then applies to the outstanding principal. An example is included.

## 2. Interest Paid by Someone Other Than the Taxpayer

Several commentators requested guidance on the treatment of an interest payment made by someone other than the taxpayer. To provide consistency with section 221(a), the final regulations provide, “Under section 221, an individual taxpayer may deduct from gross income certain interest paid by the taxpayer during the taxable year on a qualified education loan.” (Emphasis added.) The final regulations also clarify that certain third party pay-

ments of interest are treated as first paid to the taxpayer and then paid by the taxpayer to the lender, in a manner similar to the treatment of third party payments of tuition under §1.25A-5(b)(1). The final regulations provide for this treatment if a third party makes a payment of interest on a qualified education loan on behalf of a taxpayer.

Thus, for example, if a third party pays interest on behalf of the taxpayer, as a gift to the taxpayer, the taxpayer may deduct this interest for Federal income tax purposes, assuming fulfillment of all other requirements of section 221. Similarly, if an employer pays interest to a lender on behalf of the taxpayer, and the taxpayer as required by section 61 includes the payment in income for Federal income tax purposes, the taxpayer may deduct this interest, assuming fulfillment of all other requirements of section 221.

A commentator also recommended the allowance of a deduction to an individual even if the individual qualifies as a dependent of a taxpayer under section 151. This recommendation was not adopted because it is contrary to section 221(c).

## 3. Definition of Eligible Educational Institution

Several commentators suggested expanding the definition of *eligible educational institution* in a manner that is not consistent with the statutory definition under sections 221(d)(2) (formerly section 221(e)(2) (redesignated by the 2001 Act)) and 25A(f)(2). Accordingly, these comments were not adopted. Another commentator requested guidance on the deductibility of interest paid on a qualified education loan if the educational institution loses its status as an eligible educational institution after the end of the academic period for which the loan was incurred. The final regulations include a new example illustrating that the deductibility of interest on the loan is not affected by the institution’s subsequent change in status.

## 4. Definition of Qualified Education Loan

The definition of *qualified education loan* in section 221(d)(1) (formerly section 221(e)(1) (redesignated by the 2001 Act)) provides, in part, that the indebtedness must be incurred by the taxpayer

solely to pay higher education expenses that are paid within a reasonable period of time before or after the indebtedness is incurred. Several comments were received in connection with this “reasonable period of time” requirement.

One commentator suggested extending the 60-day safe harbor provided in the proposed regulations for satisfying the “reasonable period of time” requirement to 90 days or changing it so that the beginning of the safe harbor period is the earlier of 60 days prior to the start of the academic period or the end of the previous academic period. Two commentators suggested extending the safe harbor to 90 days after the end of the academic period. Another commentator expressed concern that expenses paid with loans disbursed outside the 60-day window would not satisfy the “reasonable period of time” requirement. Finally, one commentator interpreted the safe harbor to impose a 60-day limit on loans that are part of a federal postsecondary loan program.

The final regulations provide that what constitutes a reasonable period of time is determined based on all the relevant facts and circumstances. The final regulations also provide that qualified higher education expenses are treated as paid or incurred within a reasonable period of time under the following circumstances: 1) the expenses are paid with the proceeds of education loans that are part of a federal postsecondary education loan program; or 2) the expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days before the start of, and ends 90 days after the end of, the academic period to which the expenses relate.

One commentator recommended expansion of the federal loan safe harbor described above to include expenses paid with the proceeds of any non-federal loan disbursed under policies mirroring the awarding and disbursement policies governing certain federal loans. Although the final regulations do not adopt this suggestion, the IRS and Treasury Department believe that loans described by the commentator probably would fall within the 90-day safe harbor, or satisfy the “reasonable period of time” requirement based on the facts and circumstances.

Another requirement of a “qualified education loan” is that the borrower obtain the loan “solely” to pay higher education expenses. One commentator suggested that if a taxpayer refinances a qualified education loan and receives an amount in excess of the original qualified education loan, the taxpayer may take an interest deduction under section 221 for interest paid on the refinanced loan. The commentator is correct, but only if the taxpayer uses the excess amount solely to pay higher education expenses and satisfies all other requirements of a qualified education loan. Thus, if the taxpayer uses the excess amount for any other purpose, the refinanced loan is not “solely” to pay higher education expenses, and no interest paid on the loan will be deductible.

#### 5. Miscellaneous Comments and Changes

**Federal Postsecondary Education Loan Program** — The final regulations clarify that a federal postsecondary education loan program includes, but is not limited to, the Federal Perkins Loan, Federal Family Education Loan, and William D. Ford Federal Direct Loan Programs under Title IV of the Higher Education Act of 1965, and the Health Education Assistance Loan and the Nursing Student Loan Programs under Titles VII and VIII of the Public Health Service Act.

**Eligible Educational Institution** — Although the Higher Education Amendments Act of 1998 moved section 481 from Title IV to Title I, the regulations do not reflect this change, as the statutory language refers to section 481 of the Higher Education Act as in effect on the date that section 221 was enacted.

**Interest Charges on a University In-House Deferred Payment Plan** — One commentator requested clarification of the deductibility of interest charges on a university’s in-house deferred payment plan, which is a revolving credit account that can include a variety of expenditures in addition to qualified higher education expenses. This situation is addressed by *Example 6* of §1.221–1(e)(4) and *Example 6* of §1.221–2(f)(4) concerning mixed use loans.

#### 6. Refinanced and Consolidated Loans

The final regulations reserve a place for more detailed treatment of refinanced and consolidated loans.

#### 7. Periods of Deferment or Forbearance

Prior to the 2001 Act, section 221(d) stated that a “deduction shall be allowed under this section only with respect to interest paid on any qualified education loan during the first 60 months (whether or not consecutive) in which interest payments are required.”

Some commentators recommended that the 60-month limitation period should not be suspended during a period of deferment or forbearance. Other commentators suggested that the 60-month limitation period should be suspended during all periods of deferment or forbearance, whether or not the taxpayer makes payments. Commentators also asked whether rules under which the 60-month period is not suspended apply to loans made under federal programs as well as non-federal loans. Finally, commentators asked whether interest payments made during periods of reduced payment forbearance are deductible.

Section 221, prior to the 2001 Act, and the legislative history provide that only interest payments required under the terms of a loan are deductible. Under that provision, interest a borrower pays voluntarily during a period when payments are not required, such as during a period of deferment or forbearance or before loan repayment begins, is not deductible.

Therefore, §1.221–2 of the final regulations retains the rule that interest payments are not deductible if paid voluntarily during a period of deferment or forbearance. However, the final regulations provide that interest payments made during a period of deferment, forbearance, or reduced payment forbearance are deductible if required as part of the terms of the deferment, forbearance, or reduced payment agreement. The final regulations include a new example involving reduced payment forbearance.

In addition, §1.221–2 of the final regulations provides for suspension of the 60-month period for loans not issued or guaranteed under a federal postsecondary education loan program under certain conditions. The promissory note must contain

conditions for deferment or forbearance that are substantially similar to the conditions established by the U.S. Department of Education for Federal student loan programs under Title IV of the Higher Education Act of 1965 and the borrower must satisfy one of those conditions.

#### 8. Start of the 60-Month Limitation Period

A commentator expressed concern that the month a loan first enters repayment status may not be the same as the month the first interest payment is required. Section 1.221–2 of the final regulations clarifies that the beginning of the 60-month period commences on the first day of the month in which the first interest payment is required.

#### 9. Information Reporting for Interest Payments Received on Qualified Education Loans

Section 6050S requires information reporting by certain lenders or other payees that receive payments of interest on qualified education loans. Section 1.6050S–3(b)(1) provides that interest includes stated interest, loan origination fees (other than fees for services), and capitalized interest. Section 1.6050S–3(e)(1) provides a special transitional rule for reporting loan origination fees and capitalized interest. Under the transitional rule, a payee is not required to report payments of loan origination fees and capitalized interest for loans made before January 1, 2004.

Several commentators representing payees requested that the transitional rule be extended because the necessary programming changes to capture and report these amounts could not be made in the absence of final regulations under section 221. Based on the comments received, these regulations amend §1.6050S–3(e)(1) to extend the transitional rule to loans made before September 1, 2004.

#### Special Analyses

It has been determined that this Treasury decision is not a significant regulatory action as defined in Executive Order 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does

not apply to these regulations, and, because the regulations do not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Code, the proposed regulations that preceded these regulations were 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 final regulations is Sean M. Dwyer, Office of the Associate Chief Counsel (Income Tax & 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 1.221-2 also issued under 26 U.S.C. 221(d). \* \* \*

Section 1.6050S-3 also issued under 26 U.S.C. 6050S(g). \* \* \*

Par. 2. Sections 1.221-1 and 1.221-2 are added to read as follows:

*§1.221-1 Deduction for interest paid on qualified education loans after December 31, 2001.*

(a) *In general*—(1) *Applicability*. Under section 221, an individual taxpayer may deduct from gross income certain interest paid by the taxpayer during the taxable year on a qualified education loan. See paragraph (b)(4) of this section for rules on payments of interest by third parties. The rules of this section are applicable to periods governed by section 221 as amended in 2001, which relates to deductions for interest paid on qualified education loans after December 31, 2001, in taxable years ending after December 31, 2001, and on or before December 31,

2010. For rules applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002, see §1.221-2. Taxpayers also may apply §1.221-2 to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. To the extent that the effective date limitation (sunset) of the 2001 amendment remains in force unchanged, section 221 before amendment in 2001, to which §1.221-2 relates, also applies to interest due and paid on qualified education loans in taxable years beginning after December 31, 2010.

(2) *Example*. The following example illustrates the rules of this paragraph (a). In the example, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The example is as follows:

*Example. Effective dates.* Student A begins to make monthly interest payments on her loan beginning January 1, 1997. Student A continues to make interest payments in a timely fashion. However, under the effective date provisions of section 221, no deduction is allowed for interest Student A pays prior to January 1, 1998. Student A may deduct interest due and paid on the loan after December 31, 1997. Student A may apply the rules of §1.221-2 to interest due and paid during the period beginning January 1, 1998, and ending January 20, 1999. Interest due and paid during the period January 21, 1999, and ending December 31, 2001, is deductible under the rules of §1.221-2, and interest paid after December 31, 2001, is deductible under the rules of this section.

(b) *Eligibility*—(1) *Taxpayer must have a legal obligation to make interest payments*. A taxpayer is entitled to a deduction under section 221 only if the taxpayer has a legal obligation to make interest payments under the terms of the qualified education loan.

(2) *Claimed dependents not eligible*—(i) *In general*. An individual is not entitled to a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom another taxpayer is allowed a deduction under section 151 on a Federal income tax return for the same taxable year (or, in the case of a fiscal year taxpayer, the taxable year beginning in the same calendar year as the individual's taxable year).

(ii) *Examples*. The following examples illustrate the rules of this paragraph (b)(2):

*Example 1. Student not claimed as dependent.* Student B pays \$750 of interest on qualified education loans during 2003. Student B's parents are not allowed a deduction for her as a dependent for 2003. Assuming fulfillment of all other relevant requirements, Student B may deduct under section 221 the \$750 of interest paid in 2003.

*Example 2. Student claimed as dependent.* Student C pays \$750 of interest on qualified education loans during 2003. Only Student C has the legal obligation to make the payments. Student C's parent claims him as a dependent and is allowed a deduction under section 151 with respect to Student C in computing the parent's 2003 Federal income tax. Student C is not entitled to a deduction under section 221 for the \$750 of interest paid in 2003. Because Student C's parent was not legally obligated to make the payments, Student C's parent also is not entitled to a deduction for the interest.

(3) *Married taxpayers*. If a taxpayer is married as of the close of a taxable year, he or she is entitled to a deduction under this section only if the taxpayer and the taxpayer's spouse file a joint return for that taxable year.

(4) *Payments of interest by a third party*—(i) *In general*. If a third party who is not legally obligated to make a payment of interest on a qualified education loan makes a payment of interest on behalf of a taxpayer who is legally obligated to make the payment, then the taxpayer is treated as receiving the payment from the third party and, in turn, paying the interest.

(ii) *Examples*. The following examples illustrate the rules of this paragraph (b)(4):

*Example 1. Payment by employer.* Student D obtains a qualified education loan to attend college. Upon Student D's graduation from college, Student D works as an intern for a non-profit organization during which time Student D's loan is in deferment and Student D makes no interest payments. As part of the internship program, the non-profit organization makes an interest payment on behalf of Student D after the deferment period. This payment is not excluded from Student D's income under section 108(f) and is treated as additional compensation includible in Student D's gross income. Assuming fulfillment of all other requirements of section 221, Student D may deduct this payment of interest for Federal income tax purposes.

*Example 2. Payment by parent.* Student E obtains a qualified education loan to attend college. Upon graduation from college, Student E makes legally required monthly payments of principal and interest. Student E's mother makes a required monthly payment of interest as a gift to Student E. A deduction for Student E as a dependent is not allowed on another taxpayer's tax return for that taxable year. Assuming fulfillment of all other requirements of section 221, Student E may deduct this payment of interest for Federal income tax purposes.

(c) *Maximum deduction.* The amount allowed as a deduction under section 221 for any taxable year may not exceed \$2,500.

(d) *Limitation based on modified adjusted gross income*—(1) *In general.* The deduction allowed under section 221 is phased out ratably for taxpayers with modified adjusted gross income between \$50,000 and \$65,000 (\$100,000 and \$130,000 for married individuals who file a joint return). Section 221 does not allow a deduction for taxpayers with modified adjusted gross income of \$65,000 or above (\$130,000 or above for married individuals who file a joint return). See paragraph (d)(3) of this section for inflation adjustment of amounts in this paragraph (d)(1).

(2) *Modified adjusted gross income defined.* The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain United States possessions or Puerto Rico). Modified adjusted gross income must be determined under this section after taking into account the inclusions, exclusions, deductions, and limitations provided by sections 86 (social security and tier 1 railroad retirement benefits), 135 (redemption of qualified United States savings bonds), 137 (adoption assistance programs), 219 (deductible qualified retirement contributions), and 469 (limitation on passive activity losses and credits), but before taking into account the deductions provided by sections 221 and 222 (qualified tuition and related expenses).

(3) *Inflation adjustment.* For taxable years beginning after 2002, the amounts in paragraph (d)(1) of this section will be increased for inflation occurring after 2001 in accordance with section 221(f)(1). If any amount adjusted under section 221(f)(1) is not a multiple of \$5,000, the amount will be rounded to the next lowest multiple of \$5,000.

(e) *Definitions*—(1) *Eligible educational institution.* In general, an *eligible educational institution* means any college, university, vocational school, or other postsecondary educational institution described in section 481 of the Higher Education Act of 1965 (20 U.S.C. 1088), as in effect on August 5, 1997, and certified by the U.S. Department of Education

as eligible to participate in student aid programs administered by the Department, as described in section 25A(f)(2) and §1.25A-2(b). For purposes of this section, an eligible educational institution also includes an institution that conducts an internship or residency program leading to a degree or certificate awarded by an institution, a hospital, or a health care facility that offers postgraduate training.

(2) *Qualified higher education expenses*—(i) *In general.* *Qualified higher education expenses* means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 1087ll, as in effect on August 4, 1997), at an eligible educational institution, reduced by the amounts described in paragraph (e)(2)(ii) of this section. Consistent with section 472 of the Higher Education Act of 1965, a student's cost of attendance is determined by the eligible educational institution and includes tuition and fees normally assessed a student carrying the same academic workload as the student, an allowance for room and board, and an allowance for books, supplies, transportation, and miscellaneous expenses of the student.

(ii) *Reductions.* Qualified higher education expenses are reduced by any amount that is paid to or on behalf of a student with respect to such expenses and that is—

(A) A qualified scholarship that is excludable from income under section 117;

(B) An educational assistance allowance for a veteran or member of the armed forces under chapter 30, 31, 32, 34 or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code;

(C) Employer-provided educational assistance that is excludable from income under section 127;

(D) Any other amount that is described in section 25A(g)(2)(C) (relating to amounts excludable from gross income as educational assistance);

(E) Any otherwise includible amount excluded from gross income under section 135 (relating to the redemption of United States savings bonds);

(F) Any otherwise includible amount distributed from a Coverdell education savings account and excluded from gross income under section 530(d)(2); or

(G) Any otherwise includible amount distributed from a qualified tuition program and excluded from gross income under section 529(c)(3)(B).

(3) *Qualified education loan*—(i) *In general.* A *qualified education loan* means indebtedness incurred by a taxpayer solely to pay qualified higher education expenses that are—

(A) Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 152) of the taxpayer at the time the taxpayer incurs the indebtedness;

(B) Attributable to education provided during an academic period, as described in section 25A and the regulations thereunder, when the student is an eligible student as defined in section 25A(b)(3) (requiring that the student be a degree candidate carrying at least half the normal full-time workload); and

(C) Paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness.

(ii) *Reasonable Period.* Except as otherwise provided in this paragraph (e)(3)(ii), what constitutes a reasonable period of time for purposes of paragraph (e)(3)(i)(C) of this section generally is determined based on all the relevant facts and circumstances. However, qualified higher education expenses are treated as paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness if—

(A) The expenses are paid with the proceeds of education loans that are part of a Federal postsecondary education loan program; or

(B) The expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days prior to the start of that academic period and ends 90 days after the end of that academic period.

(iii) *Related party.* A qualified education loan does not include any indebtedness owed to a person who is related to the taxpayer, within the meaning of section 267(b) or 707(b)(1). For example, a parent or grandparent of the taxpayer is a related person. In addition, a qualified education loan does not include a loan made under any qualified employer plan as defined in section 72(p)(4) or under any contract referred to in section 72(p)(5).

(iv) *Federal issuance or guarantee not required.* A loan does not have to be issued or guaranteed under a Federal postsecondary education loan program to be a qualified education loan.

(v) *Refinanced and consolidated indebtedness—(A) In general.* A qualified education loan includes indebtedness incurred solely to refinance a qualified education loan. A qualified education loan includes a single, consolidated indebtedness incurred solely to refinance two or more qualified education loans of a borrower.

(B) *Treatment of refinanced and consolidated indebtedness.* [Reserved.]

(4) *Examples.* The following examples illustrate the rules of this paragraph (e):

*Example 1. Eligible educational institution.* University F is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. The U.S. Department of Education has certified that University F is eligible to participate in federal financial aid programs administered by that Department, although University F chooses not to participate. University F is an eligible educational institution.

*Example 2. Qualified higher education expenses.* Student G receives a \$3,000 qualified scholarship for the 2003 fall semester that is excludable from Student G's gross income under section 117. Student G receives no other forms of financial assistance with respect to the 2003 fall semester. Student G's cost of attendance for the 2003 fall semester, as determined by Student G's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 2003 fall semester, Student G has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

*Example 3. Qualified education loan.* Student H borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. Student H uses all the loan proceeds to pay qualified higher education expenses incurred within a reasonable period of time after incurring the indebtedness. The loan is not federally guaranteed. The commercial bank is not related to Student H within the meaning of section 267(b) or 707(b)(1). Student H's loan is a qualified education loan within the meaning of section 221.

*Example 4. Qualified education loan.* Student I signs a promissory note for a loan on August 15, 2003, to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters. On August 20, 2003, the lender disburses loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for the 2003 fall semester, which begins on August 25, 2003. On January 26, 2004, the lender disburses additional loan proceeds to Student I's college. The college credits them to Student I's account to pay qualified higher education expenses for

the 2004 spring semester, which began on January 12, 2004. Student I's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement occurred within the 90 days prior to the start of the fall 2003 semester and the second loan disbursement occurred during the spring 2004 semester.

*Example 5. Qualified education loan.* The facts are the same as in *Example 4* except that in 2005 the college is not an eligible educational institution because it loses its eligibility to participate in certain federal financial aid programs administered by the U.S. Department of Education. The qualification of Student I's loan, which was used to pay for qualified higher education expenses for the 2003 fall and 2004 spring semesters, as a qualified education loan is not affected by the college's subsequent loss of eligibility.

*Example 6. Mixed-use loans.* Student J signs a promissory note for a loan secured by Student J's personal residence. Student J will use part of the loan proceeds to pay for certain improvements to Student J's residence and part of the loan proceeds to pay qualified higher education expenses of Student J's spouse. Because Student J obtains the loan not solely to pay qualified higher education expenses, the loan is not a qualified education loan.

(f) *Interest—(1) In general.* Amounts paid on a qualified education loan are deductible under section 221 if the amounts are interest for federal income tax purposes. For example, interest includes—

(i) Qualified stated interest (as defined in §1.1273-1(c)); and

(ii) Original issue discount, which generally includes capitalized interest. For purposes of section 221, capitalized interest means any accrued and unpaid interest on a qualified education loan that, in accordance with the terms of the loan, is added by the lender to the outstanding principal balance of the loan.

(2) *Operative rules for original issue discount—(i) In general.* The rules to determine the amount of original issue discount on a loan and the accruals of the discount are in sections 163(e), 1271 through 1275, and the regulations thereunder. In general, original issue discount is the excess of a loan's stated redemption price at maturity (all payments due under the loan other than qualified stated interest payments) over its issue price (the amount loaned). Although original issue discount generally is deductible as it accrues under section 163(e) and §1.163-7, original issue discount on a qualified education loan is not deductible until paid. See paragraph (f)(3) of this section to determine when original issue discount is paid.

(ii) *Treatment of loan origination fees by the borrower.* If a loan origination fee

is paid by the borrower other than for property or services provided by the lender, the fee reduces the issue price of the loan, which creates original issue discount (or additional original issue discount) on the loan in an amount equal to the fee. See §1.1273-2(g). For an example of how a loan origination fee is taken into account, see *Example 2* of paragraph (f)(4) of this section.

(3) *Allocation of payments.* See §§1.446-2(e) and 1.1275-2(a) for rules on allocating payments between interest and principal. In general, these rules treat a payment first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, and second as a payment of principal. The characterization of a payment as either interest or principal under these rules applies regardless of how the parties label the payment (either as interest or principal). Accordingly, the taxpayer may deduct the portion of a payment labeled as principal that these rules treat as a payment of interest on the loan, including any portion attributable to capitalized interest or loan origination fees.

(4) *Examples.* The following examples illustrate the rules of this paragraph (f). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The examples are as follows:

*Example 1. Capitalized interest.* Interest on Student K's loan accrues while Student K is in school, but Student K is not required to make any payments on the loan until six months after he graduates or otherwise leaves school. At that time, the lender capitalizes all accrued but unpaid interest and adds it to the outstanding principal amount of the loan. Thereafter, Student K is required to make monthly payments of interest and principal on the loan. The interest payable on the loan, including the capitalized interest, is original issue discount. See section 1273 and the regulations thereunder. Therefore, in determining the total amount of interest paid on the loan each taxable year, Student K may deduct any payments that §1.1275-2(a) treats as payments of interest, including any principal payments that are treated as payments of capitalized interest. See paragraph (f)(3) of this section.

*Example 2. Allocation of payments.* The facts are the same as in *Example 1*, except that, in addition, the lender charges Student K a loan origination fee, which is not for any property or services provided by the lender. Under §1.1273-2(g), the loan



origination fee reduces the issue price of the loan, which reduction increases the amount of original issue discount on the loan by the amount of the fee. The amount of original issue discount (which includes the capitalized interest and loan origination fee) that accrues each year is determined under section 1272 and §1.1272-1. In effect, the loan origination fee accrues over the entire term of the loan. Because the loan has original issue discount, the payment ordering rules in §1.1275-2(a) must be used to determine how much of each payment is interest for federal tax purposes. See paragraph (f)(3) of this section. Under §1.1275-2(a), each payment (regardless of its designation by the parties as either interest or principal) generally is treated first as a payment of original issue discount, to the extent of the original issue discount that has accrued as of the date the payment is due and has not been allocated to prior payments, and second as a payment of principal. Therefore, in determining the total amount of interest paid on the qualified education loan for a taxable year, Student K may deduct any payments that the parties label as principal but that are treated as payments of original issue discount under §1.1275-2(a).

(g) *Additional Rules*—(1) *Payment of interest made during period when interest payment not required.* Payments of interest on a qualified education loan to which this section is applicable are deductible even if the payments are made during a period when interest payments are not required because, for example, the loan has not yet entered repayment status or is in a period of deferment or forbearance.

(2) *Denial of double benefit.* No deduction is allowed under this section for any amount for which a deduction is allowable under another provision of Chapter 1 of the Internal Revenue Code. No deduction is allowed under this section for any amount for which an exclusion is allowable under section 108(f) (relating to cancellation of indebtedness).

(3) *Examples.* The following examples illustrate the rules of this paragraph (g). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, and the student is legally obligated to make interest payments under the terms of the loan:

*Example 1. Voluntary payment of interest before loan has entered repayment status.* Student L obtains a loan to attend college. The terms of the loan provide that interest accrues on the loan while Student L earns his undergraduate degree but that Student L is not required to begin making payments of interest until six full calendar months after he graduates or otherwise leaves school. Nevertheless, Student L voluntarily pays interest on the loan during 2003, while enrolled in college. Assuming all other relevant requirements are met, Student L is allowed a deduction for interest paid while attending college even though the

payments were made before interest payments were required.

*Example 2. Voluntary payment during period of deferment or forbearance.* The facts are the same as in *Example 2*, except that Student L makes no payments on the loan while enrolled in college. Student L graduates in June 2003 and begins making monthly payments of principal and interest on the loan in January 2004, as required by the terms of the loan. In August 2004, Student L enrolls in graduate school on a full-time basis. Under the terms of the loan, Student L may apply for deferment of the loan payments while Student L is enrolled in graduate school. Student L applies for and receives a deferment on the outstanding loan. However, Student L continues to make some monthly payments of interest during graduate school. Student L may deduct interest paid on the loan during the period beginning in January 2004, including interest paid while Student L is enrolled in graduate school.

(h) *Effective date.* This section is applicable to periods governed by section 221 as amended in 2001, which relates to interest paid on a qualified education loan after December 31, 2001, in taxable years ending after December 31, 2001, and on or before December 31, 2010.

#### *§1.221-2 Deduction for interest due and paid on qualified education loans before January 1, 2002.*

(a) *In general.* Under section 221, an individual taxpayer may deduct from gross income certain interest due and paid by the taxpayer during the taxable year on a qualified education loan. The deduction is allowed only with respect to interest due and paid on a qualified education loan during the first 60 months that interest payments are required under the terms of the loan. See paragraph (e) of this section for rules relating to the 60-month rule. See paragraph (b)(4) of this section for rules on payments of interest by third parties. The rules of this section are applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002. Taxpayers also may apply the rules of this section to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. To the extent that the effective date limitation (“sunset”) of the 2001 amendment remains in force unchanged, section 221 before amendment in 2001, to which this section relates, also applies to interest due and paid on qualified education loans in taxable years beginning after December 31, 2010. For rules applicable to periods governed by section 221 as amended in

2001, which relates to deductions for interest paid on qualified education loans after December 31, 2001, in taxable years ending after December 31, 2001, and before January 1, 2011, see §1.221-1.

(b) *Eligibility*—(1) *Taxpayer must have a legal obligation to make interest payments.* A taxpayer is entitled to a deduction under section 221 only if the taxpayer has a legal obligation to make interest payments under the terms of the qualified education loan.

(2) *Claimed dependents not eligible*—(i) *In general.* An individual is not entitled to a deduction under section 221 for a taxable year if the individual is a dependent (as defined in section 152) for whom another taxpayer is allowed a deduction under section 151 on a Federal income tax return for the same taxable year (or, in the case of a fiscal year taxpayer, the taxable year beginning in the same calendar year as the individual’s taxable year).

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(2):

*Example 1. Student not claimed as dependent.* Student A pays \$750 of interest on qualified education loans during 1998. Student A’s parents are not allowed a deduction for her as a dependent for 1998. Assuming fulfillment of all other relevant requirements, Student A may deduct the \$750 of interest paid in 1998 under section 221.

*Example 2. Student claimed as dependent.* Student B pays \$750 of interest on qualified education loans during 1998. Only Student B has the legal obligation to make the payments. Student B’s parent claims him as a dependent and is allowed a deduction under section 151 with respect to Student B in computing the parent’s 1998 Federal income tax. Student B may not deduct the \$750 of interest paid in 1998 under section 221. Because Student B’s parent was not legally obligated to make the payments, Student B’s parent also may not deduct the interest.

(3) *Married taxpayers.* If a taxpayer is married as of the close of a taxable year, he or she is entitled to a deduction under this section only if the taxpayer and the taxpayer’s spouse file a joint return for that taxable year.

(4) *Payments of interest by a third party*—(i) *In general.* If a third party who is not legally obligated to make a payment of interest on a qualified education loan makes a payment of interest on behalf of a taxpayer who is legally obligated to make the payment, then the taxpayer is treated as receiving the payment from the third party and, in turn, paying the interest.

(ii) *Examples.* The following examples illustrate the rules of this paragraph (b)(4):

*Example 1. Payment by employer.* Student C obtains a qualified education loan to attend college. Upon Student C's graduation from college, Student C works as an intern for a non-profit organization during which time Student C's loan is in deferment and Student C makes no interest payments. As part of the internship program, the non-profit organization makes an interest payment on behalf of Student C after the deferment period. This payment is not excluded from Student C's income under section 108(f) and is treated as additional compensation includible in Student C's gross income. Assuming fulfillment of

all other requirements of section 221, Student C may deduct this payment of interest for Federal income tax purposes.

*Example 2. Payment by parent.* Student D obtains a qualified education loan to attend college. Upon graduation from college, Student D makes legally required monthly payments of principal and interest. Student D's mother makes a required monthly payment of interest as a gift to Student D. A deduction for Student D as a dependent is not allowed on another taxpayer's tax return for that taxable year. Assuming fulfillment of all other requirements of sec-

tion 221, Student D may deduct this payment of interest for Federal income tax purposes.

(c) *Maximum deduction.* In any taxable year beginning before January 1, 2002, the amount allowed as a deduction under section 221 may not exceed the amount determined in accordance with the following table:

<i>Taxable Year Beginning in</i>	<i>Maximum Deduction</i>
1998	\$1,000
1999	\$1,500
2000	\$2,000
2001	\$2,500

(d) *Limitation based on modified adjusted gross income*—(1) *In general.* The deduction allowed under section 221 is phased out ratably for taxpayers with modified adjusted gross income between \$40,000 and \$55,000 (\$60,000 and \$75,000 for married individuals who file a joint return). Section 221 does not allow a deduction for taxpayers with modified adjusted gross income of \$55,000 or above (\$75,000 or above for married individuals who file a joint return).

(2) *Modified adjusted gross income defined.* The term *modified adjusted gross income* means the adjusted gross income (as defined in section 62) of the taxpayer for the taxable year increased by any amount excluded from gross income under section 911, 931, or 933 (relating to income earned abroad or from certain United States possessions or Puerto Rico). Modified adjusted gross income must be determined under this section after taking into account the inclusions, exclusions, deductions, and limitations provided by sections 86 (social security and tier 1 railroad retirement benefits), 135 (redemption of qualified United States savings bonds), 137 (adoption assistance programs), 219 (deductible qualified retirement contributions), and 469 (limitation on passive activity losses and credits), but before taking into account the deduction provided by section 221.

(e) *60-month rule*—(1) *In general.* A deduction for interest paid on a qualified education loan is allowed only for payments made during the first 60 months that interest payments are required on the loan.

The 60-month period begins on the first day of the month that includes the date on which interest payments are first required and ends 60 months later, unless the 60-month period is suspended for periods of deferment or forbearance within the meaning of paragraph (e)(3) of this section. The 60-month period continues to run regardless of whether the required interest payments are actually made. The date on which the first interest payment is required is determined under the terms of the loan agreement or, in the case of a loan issued or guaranteed under a federal postsecondary education loan program (such as loan programs under Title IV of the Higher Education Act of 1965 (20 U.S.C. 1070) and Titles VII and VIII of the Public Health Service Act (42 U.S.C. 292, and 42 U.S.C. 296) under applicable Federal regulations. For a discussion of interest, see paragraph (h) of this section. For special rules relating to loan refinancings, consolidated loans, and collapsed loans, see paragraph (i) of this section.

(2) *Loans that entered repayment status prior to January 1, 1998.* In the case of any qualified education loan that entered repayment status prior to January 1, 1998, section 221 allows no deduction for interest paid during the portion of the 60-month period described in paragraph (e)(1) of this section that occurred prior to January 1, 1998. Section 221 allows a deduction only for interest due and paid during that portion, if any, of the 60-month period remaining after December 31, 1997.

(3) *Periods of deferment or forbearance.* The 60-month period described in paragraph (e)(1) of this section generally is suspended for any period when interest payments are not required on a qualified education loan because the lender has granted the taxpayer a period of deferment or forbearance (including postponement in anticipation of cancellation). However, in the case of a qualified education loan that is not issued or guaranteed under a Federal postsecondary education loan program, the 60-month period will be suspended under this paragraph (e)(3) only if the promissory note contains conditions substantially similar to the conditions for deferment or forbearance established by the U.S. Department of Education for Federal student loan programs under Title IV of the Higher Education Act of 1965, such as half-time study at a postsecondary educational institution, study in an approved graduate fellowship program or in an approved rehabilitation program for the disabled, inability to find full-time employment, economic hardship, or the performance of services in certain occupations or federal programs, and the borrower satisfies one of those conditions. For any qualified education loan, the 60-month period is not suspended if under the terms of the loan interest continues to accrue while the loan is in deferment or forbearance and either—

(i) In the case of deferment, the taxpayer agrees to pay interest currently during the deferment period; or

(ii) In the case of forbearance, the taxpayer agrees to make reduced payments, or

payments of interest only, during the forbearance period.

(4) *Late payments.* A deduction is allowed for a payment of interest required in one month but actually made in a subsequent month prior to the expiration of the 60-month period. A deduction is not allowed for a payment of interest required in one month but actually made in a subsequent month after the expiration of the 60-month period. A late payment made during a period of deferment or forbearance is treated, solely for purposes of determining whether it is made during the 60-month period, as made on the date it is due.

(5) *Examples.* The following examples illustrate the rules of this paragraph (e). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan and is issued or guaranteed under a federal postsecondary education loan program, the student is legally obligated to make interest payments under the terms of the loan, the interest payments occur after December 31, 1997, but before January 1, 2002, and with respect to any period after December 31, 1997, but before January 21, 1999, the taxpayer elects to apply the rules of this section. The examples are as follows:

*Example 1. Payment prior to 60-month period.* Student E obtains a loan to attend college. The terms of the loan provide that interest accrues on the loan while Student E earns his undergraduate degree but that Student E is not required to begin making payments of interest until six full calendar months after he graduates. Nevertheless, Student E voluntarily pays interest on the loan while attending college. Student E is not allowed a deduction for interest paid during that period, because those payments were made prior to the start of the 60-month period. Similarly, Student E would not be allowed a deduction for any interest paid during the six month grace period after graduation when interest payments are not required.

*Example 2. Deferment option not exercised.* The facts are the same as in *Example 1* except that Student E makes no payments on the loan while enrolled in college. Student E graduates in June 1999, and is required to begin making monthly payments of principal and interest on the loan in January 2000. The 60-month period described in paragraph (e)(1) of this section begins in January 2000. In August 2000, Student E enrolls in graduate school on a full-time basis. Under the terms of the loan, Student E may apply for deferment of the loan payments while enrolled in graduate school. However, Student E elects not to apply for deferment and continues to make required monthly payments on the loan during graduate school. Assuming fulfillment of all other relevant requirements, Student E may deduct interest paid on the loan during the 60-month period beginning in January

2000, including interest paid while enrolled in graduate school.

*Example 3. Late payment, within 60-month period.* The facts are the same as in *Example 2* except that, after the loan enters repayment status in January 2000, Student E makes no interest payments until March 2000. In March 2000, Student E pays interest required for the months of January, February, and March 2000. Assuming fulfillment of all other relevant requirements, Student E may deduct the interest paid in March for the months of January, February, and March because the interest payments are required under the terms of the loan and are paid within the 60-month period, even though the January and February interest payments may be late.

*Example 4. Late payment during deferment but within 60-month period.* The terms of Student F's loan require her to begin making monthly payments of interest on the loan in January 2000. The 60-month period described in paragraph (e)(1) of this section begins in January 2000. Student F fails to make the required interest payments for the months of November and December 2000. In January 2001, Student F enrolls in graduate school on a half-time basis. Under the terms of the loan, Student F obtains a deferment of the loan payments due while enrolled in graduate school. The deferment becomes effective January 1, 2001. In March 2001, while the loan is in deferment, Student F pays the interest due for the months of November and December 2000. Assuming fulfillment of all other relevant requirements, Student F may deduct interest paid in March 2001, for the months of November and December 2000, because the late interest payments are treated, solely for purposes of determining whether they were made during the 60-month period, as made in November and December 2000.

*Example 5. 60-month period.* The terms of Student G's loan require him to begin making monthly payments of interest on the loan in November 1999. The 60-month period described in paragraph (e)(1) of this section begins in November 1999. In January 2000, Student G enrolls in graduate school on a half-time basis. As permitted under the terms of the loan, Student G applies for deferment of the loan payments due while enrolled in graduate school. While awaiting formal approval from the lender of his request for deferment, Student G pays interest due for the month of January 2000. In February 2000, the lender approves Student G's request for deferment, effective as of January 1, 2000. Assuming fulfillment of all other relevant requirements, Student G may deduct interest paid in January 2000, prior to his receipt of the lender's approval, even though the deferment was retroactive to January 1, 2000. As of February 2000, there are 57 months remaining in the 60-month period for that loan. Because Student G is not required to make interest payments during the period of deferment, the 60-month period is suspended. After January 2000, Student G may not deduct any voluntary payments of interest made during the period of deferment.

*Example 6. 60-month period.* The terms of Student H's loan require her to begin making monthly payments of interest on the loan in November 1999. The 60-month period described in paragraph (e)(1) of this section begins in November 1999. In January 2000, Student H enrolls in graduate school on a half-time basis. As permitted under the terms of

the loan, Student H applies to make reduced payments of principal and interest while enrolled in graduate school. After the lender approves her application, Student H pays principal and interest due for the month of January 2000 at the reduced rate. Assuming fulfillment of all other relevant requirements, Student H may deduct interest paid in January 2000. As of February 2000, there are 57 months remaining in the 60-month period for that loan.

*Example 7. Reduction of 60-month period for months prior to January 1, 1998.* The first payment of interest on a loan is due in January 1997. Thereafter, interest payments are required on a monthly basis. The 60-month period described in paragraph (e)(1) of this section for this loan begins on January 1, 1997, the first day of the month that includes the date on which the first interest payment is required. However, the borrower may not deduct interest paid prior to January 1, 1998, under the effective date provisions of section 221. Assuming fulfillment of all other relevant requirements, the borrower may deduct interest due and paid on the loan during the 48 months beginning on January 1, 1998 (unless such period is extended for periods of deferment or forbearance under paragraph (e)(3) of this section).

(f) *Definitions—(1) Eligible educational institution.* In general, an *eligible educational institution* means any college, university, vocational school, or other post-secondary educational institution described in section 481 of the Higher Education Act of 1965, 20 U.S.C. 1088, as in effect on August 5, 1997, and certified by the U.S. Department of Education as eligible to participate in student aid programs administered by the Department, as described in section 25A(f)(2) and § 1.25A-2(b). For purposes of this section, an eligible educational institution also includes an institution that conducts an internship or residency program leading to a degree or certificate awarded by an institution, a hospital, or a health care facility that offers postgraduate training.

(2) *Qualified higher education expenses—(i) In general.* *Qualified higher education expenses* means the cost of attendance (as defined in section 472 of the Higher Education Act of 1965, 20 U.S.C. 108711, as in effect on August 4, 1997), at an eligible educational institution, reduced by the amounts described in paragraph (f)(2)(ii) of this section. Consistent with section 472 of the Higher Education Act of 1965, a student's cost of attendance is determined by the eligible educational institution and includes tuition and fees normally assessed a student carrying the same academic workload as the student, an allowance for room and board, and an allowance for books, supplies, transporta-

tion, and miscellaneous expenses of the student.

(ii) *Reductions.* Qualified higher education expenses are reduced by any amount that is paid to or on behalf of a student with respect to such expenses and that is—

(A) A qualified scholarship that is excludable from income under section 117;

(B) An educational assistance allowance for a veteran or member of the armed forces under chapter 30, 31, 32, 34 or 35 of title 38, United States Code, or under chapter 1606 of title 10, United States Code;

(C) Employer-provided educational assistance that is excludable from income under section 127;

(D) Any other amount that is described in section 25A(g)(2)(C) (relating to amounts excludable from gross income as educational assistance);

(E) Any otherwise includible amount excluded from gross income under section 135 (relating to the redemption of United States savings bonds); or

(F) Any otherwise includible amount distributed from a Coverdell education savings account and excluded from gross income under section 530(d)(2).

(3) *Qualified education loan*—(i) *In general.* A qualified education loan means indebtedness incurred by a taxpayer solely to pay qualified higher education expenses that are—

(A) Incurred on behalf of a student who is the taxpayer, the taxpayer's spouse, or a dependent (as defined in section 152) of the taxpayer at the time the taxpayer incurs the indebtedness;

(B) Attributable to education provided during an academic period, as described in section 25A and the regulations thereunder, when the student is an eligible student as defined in section 25A(b)(3) (requiring that the student be a degree candidate carrying at least half the normal full-time workload); and

(C) Paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness.

(ii) *Reasonable period.* Except as otherwise provided in this paragraph (f)(3)(ii), what constitutes a reasonable period of time for purposes of paragraph (f)(3)(i)(C) of this section generally is determined based on all the relevant facts and circumstances. However, qualified

higher education expenses are treated as paid or incurred within a reasonable period of time before or after the taxpayer incurs the indebtedness if—

(A) The expenses are paid with the proceeds of education loans that are part of a federal postsecondary education loan program; or

(B) The expenses relate to a particular academic period and the loan proceeds used to pay the expenses are disbursed within a period that begins 90 days prior to the start of that academic period and ends 90 days after the end of that academic period.

(iii) *Related party.* A qualified education loan does not include any indebtedness owed to a person who is related to the taxpayer, within the meaning of section 267(b) or 707(b)(1). For example, a parent or grandparent of the taxpayer is a related person. In addition, a qualified education loan does not include a loan made under any qualified employer plan as defined in section 72(p)(4) or under any contract referred to in section 72(p)(5).

(iv) *Federal issuance or guarantee not required.* A loan does not have to be issued or guaranteed under a federal postsecondary education loan program to be a qualified education loan.

(v) *Refinanced and consolidated indebtedness*—(A) *In general.* A qualified education loan includes indebtedness incurred solely to refinance a qualified education loan. A qualified education loan includes a single, consolidated indebtedness incurred solely to refinance two or more qualified education loans of a borrower.

(B) *Treatment of refinanced and consolidated indebtedness.* [Reserved.]

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

*Example 1. Eligible educational institution.* University J is a postsecondary educational institution described in section 481 of the Higher Education Act of 1965. The U.S. Department of Education has certified that University J is eligible to participate in federal financial aid programs administered by that Department, although University J chooses not to participate. University J is an eligible educational institution.

*Example 2. Qualified higher education expenses.* Student K receives a \$3,000 qualified scholarship for the 1999 fall semester that is excludable from Student K's gross income under section 117. Student K receives no other forms of financial assistance with respect to the 1999 fall semester. Student K's cost of attendance for the 1999 fall semester, as determined by

Student K's eligible educational institution for purposes of calculating a student's financial need in accordance with section 472 of the Higher Education Act, is \$16,000. For the 1999 fall semester, Student K has qualified higher education expenses of \$13,000 (the cost of attendance as determined by the institution (\$16,000) reduced by the qualified scholarship proceeds excludable from gross income (\$3,000)).

*Example 3. Qualified education loan.* Student L borrows money from a commercial bank to pay qualified higher education expenses related to his enrollment on a half-time basis in a graduate program at an eligible educational institution. Student L uses all the loan proceeds to pay qualified higher education expenses incurred within a reasonable period of time after incurring the indebtedness. The loan is not federally guaranteed. The commercial bank is not related to Student L within the meaning of section 267(b) or 707(b)(1). Student L's loan is a qualified education loan within the meaning of section 221.

*Example 4. Qualified education loan.* Student M signs a promissory note for a loan on August 15, 1999, to pay for qualified higher education expenses for the 1999 fall and 2000 spring semesters. On August 20, 1999, the lender disburses loan proceeds to Student M's college. The college credits them to Student M's account to pay qualified higher education expenses for the 1999 fall semester, which begins on August 23, 1999. On January 25, 2000, the lender disburses additional loan proceeds to Student M's college. The college credits them to Student M's account to pay qualified higher education expenses for the 2000 spring semester, which began on January 10, 2000. Student M's qualified higher education expenses for the two semesters are paid within a reasonable period of time, as the first loan disbursement occurred within the 90 days prior to the start of the fall 1999 semester, and the second loan disbursement occurred during the spring 2000 semester.

*Example 5. Qualified education loan.* The facts are the same as in *Example 4*, except that in 2001 the college is not an eligible educational institution because it loses its eligibility to participate in certain federal financial aid programs administered by the U.S. Department of Education. The qualification of Student M's loan, which was used to pay for qualified higher education expenses for the 1999 fall and 2000 spring semesters, as a qualified education loan is not affected by the college's subsequent loss of eligibility.

*Example 6. Mixed-use loans.* Student N signs a promissory note for a loan that is secured by Student N's personal residence. Student N will use part of the loan proceeds to pay for certain improvements to Student N's residence and part of the loan proceeds to pay qualified higher education expenses of Student N's spouse. Because Student N obtains the loan not solely to pay qualified higher education expenses, the loan is not a qualified education loan.

(g) *Denial of double benefit.* No deduction is allowed under this section for any amount for which a deduction is allowable under another provision of Chapter 1 of the Internal Revenue Code. No deduction is allowed under this section for any amount for which an exclusion is allowable under

section 108(f) (relating to cancellation of indebtedness).

(h) *Interest*—(1) *In general*. Amounts paid on a qualified education loan are deductible under section 221 if the amounts are interest for Federal income tax purposes. For example, interest includes—

(i) Qualified stated interest (as defined in §1.1273-1(c)); and

(ii) Original issue discount, which generally includes capitalized interest. For purposes of section 221, capitalized interest means any accrued and unpaid interest on a qualified education loan that, in accordance with the terms of the loan, is added by the lender to the outstanding principal balance of the loan.

(2) *Operative rules for original issue discount*—(i) *In general*. The rules to determine the amount of original issue discount on a loan and the accruals of the discount are in sections 163(e), 1271 through 1275, and the regulations thereunder. In general, original issue discount is the excess of a loan's stated redemption price at maturity (all payments due under the loan other than qualified stated interest payments) over its issue price (the amount loaned). Although original issue discount generally is deductible as it accrues under section 163(e) and §1.163-7, original issue discount on a qualified education loan is not deductible until paid. See paragraph (h)(3) of this section to determine when original issue discount is paid.

(ii) *Treatment of loan origination fees by the borrower*. If a loan origination fee is paid by the borrower other than for property or services provided by the lender, the fee reduces the issue price of the loan, which creates original issue discount (or additional original issue discount) on the loan in an amount equal to the fee. See §1.1273-2(g). For an example of how a loan origination fee is taken into account, see *Example 2* of paragraph (h)(4) of this section.

(3) *Allocation of payments*. See §§1.446-2(e) and 1.1275-2(a) for rules on allocating payments between interest and principal. In general, these rules treat a payment first as a payment of interest to the extent of the interest that has accrued and remains unpaid as of the date the payment is due, and second as a payment of principal. The characterization of a payment as either interest or principal under these rules applies regardless of how the

parties label the payment (either as interest or principal). Accordingly, the taxpayer may deduct the portion of a payment labeled as principal that these rules treat as a payment of interest on the loan, including any portion attributable to capitalized interest or loan origination fees.

(4) *Examples*. The following examples illustrate the rules of this paragraph (h). In the examples, assume that the institution the student attends is an eligible educational institution, the loan is a qualified education loan, the student is legally obligated to make interest payments under the terms of the loan, and any other applicable requirements, if not otherwise specified, are fulfilled. The examples are as follows:

*Example 1. Capitalized interest*. Interest on Student O's qualified education loan accrues while Student O is in school, but Student O is not required to make any payments on the loan until six months after he graduates or otherwise leaves school. At that time, the lender capitalizes all accrued but unpaid interest and adds it to the outstanding principal amount of the loan. Thereafter, Student O is required to make monthly payments of interest and principal on the loan. The interest payable on the loan, including the capitalized interest, is original issue discount. Therefore, in determining the total amount of interest paid on the qualified education loan during the 60-month period described in paragraph (e)(1) of this section, Student O may deduct any payments that §1.1275-2(a) treats as payments of interest, including any principal payments that are treated as payments of capitalized interest. See paragraph (h)(3) of this section.

*Example 2. Allocation of payments*. The facts are the same as in *Example 1* of this paragraph (h)(4), except that, in addition, the lender charges Student O a loan origination fee, which is not for any property or services provided by the lender. Under §1.1273-2(g), the loan origination fee reduces the issue price of the loan, which reduction increases the amount of original issue discount on the loan by the amount of the fee. The amount of original issue discount (which includes the capitalized interest and loan origination fee) that accrues each year is determined under section 1272 and §1.1272-1. In effect, the loan origination fee accrues over the entire term of the loan. Because the loan has original issue discount, the payment ordering rules in §1.1275-2(a) must be used to determine how much of each payment is interest for federal tax purposes. See paragraph (h)(3) of this section. Under §1.1275-2(a), each payment (regardless of its designation by the parties as either interest or principal) generally is treated first as a payment of original issue discount, to the extent of the original issue discount that has accrued as of the date the payment is due and has not been allocated to prior payments, and second as a payment of principal. Therefore, in determining the total amount of interest paid on the qualified education loan during the 60-month period described in paragraph (e)(1) of this section, Student O may deduct any payments that the parties label as principal but that are treated as payments

of original issue discount under §1.1275-2(a). The 60-month period does not begin in the month in which the lender charges Student O the loan origination fee.

(i) *Special rules regarding 60-month limitation*—(1) *Refinancing*. A qualified education loan and all indebtedness incurred solely to refinance that loan constitute a single loan for purposes of calculating the 60-month period described in paragraph (e)(1) of this section.

(2) *Consolidated loans*. A consolidated loan is a single loan that refinances more than one qualified education loan of a borrower. For consolidated loans, the 60-month period described in paragraph (e)(1) of this section begins on the latest date on which any of the underlying loans entered repayment status and includes any subsequent month in which the consolidated loan is in repayment status.

(3) *Collapsed loans*. A collapsed loan is two or more qualified education loans of a single taxpayer that constitute a single qualified education loan for loan servicing purposes and for which the lender or servicer does not separately account. For a collapsed loan, the 60-month period described in paragraph (e)(1) of this section begins on the latest date on which any of the underlying loans entered repayment status and includes any subsequent month in which any of the underlying loans is in repayment status.

(4) *Examples*. The following examples illustrate the rules of this paragraph (i):

*Example 1. Refinancing*. Student P obtains a qualified education loan to pay for an undergraduate degree at an eligible educational institution. After graduation, Student P is required to make monthly interest payments on the loan beginning in January 2000. Student P makes the required interest payments for 15 months. In April 2001, Student P borrows money from another lender exclusively to repay the first qualified education loan. The new loan requires interest payments to start immediately. At the time Student P must begin interest payments on the new loan, which is a qualified education loan, there are 45 months remaining of the original 60-month period referred to in paragraph (e)(1) of this section.

*Example 2. Collapsed loans*. To finance his education, Student Q obtains four separate qualified education loans from Lender R. The loans enter repayment status, and their respective 60-month periods described in paragraph (e)(1) of this section begin, in July, August, September, and December of 1999. After all of Student Q's loans have entered repayment status, Lender R informs Student Q that Lender R will transfer all four loans to Lender S. Following the transfer, Lender S treats the loans as a single loan for loan servicing purposes. Lender S sends Student Q a single statement that shows the total principal and interest, and does not keep separate records with respect to each loan. With respect to the single col-

lapsed loan, the 60-month period described in paragraph (e)(1) of this section begins in December 1999.

(j) *Effective date.* This section is applicable to interest due and paid on qualified education loans after January 21, 1999, if paid before January 1, 2002. Taxpayers also may apply this section to interest due and paid on qualified education loans after December 31, 1997, but before January 21, 1999. This section also applies to interest due and paid on qualified education loans in a taxable year beginning after December 31, 2010.

Par. 3. Section 1.6050S-3 is amended by revising paragraphs (d)(1)(iii)(B) and (e)(1) to read as follows:

*§1.6050S-3 Information reporting for payments of interest on qualified education loans.*

\* \* \* \* \*

(d)\* \* \* (1)\* \* \*  
(iii)\* \* \*

(B) In the case of qualified education loans made before September 1, 2004, for which the payee does not report payments of interest other than stated interest, state that the payor may be able to deduct additional amounts (such as certain loan origination fees and capitalized interest) not reported on the statement;

\* \* \* \* \*

(e) *Special rules*—(1) *Transitional rule for reporting of loan origination fees and capitalized interest* — (i) *Loans made before September 1, 2004.* For qualified education loans made before September 1, 2004, a payee is not required to report payments of loan origination fees or capitalized interest or to take such payments into account in determining the \$600 amount for purposes of paragraph (a)(1) of this section.

(ii) *Loans made on or after September 1, 2004.* For qualified education loans made on or after September 1, 2004, a payee is required to report payments of interest as described in §1.221-1(f). Under §1.221-1(f), interest includes loan origination fees that represent charges for the use or forbearance of money and capitalized interest. Under this paragraph (e)(1)(ii), a payee shall take such payments of interest into account in determining the \$600 amount for purposes of paragraph (a)(1) of this section. For purposes of this section

and section 6050S, interest (including capitalized interest and loan origination fees) is treated as received, and is reportable, in the year the interest is treated as paid under the allocation rules in §1.221-1(f)(3).

See §1.221-1(f) for rules relating to capitalized interest, and §1.221-1(f)(2)(ii) for rules relating to loan origination fees, on qualified education loans.

\* \* \* \* \*

Mark E. Matthews,  
*Deputy Commissioner for  
Services and Enforcement.*

Approved April 27, 2004.

Gregory F. Jenner,  
*Acting Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on May 6, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 7, 2004, 69 F.R. 25489)

### **Section 280G.—Golden Parachute Payments**

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 382.—Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change**

The adjusted applicable federal long-term rate is set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 412.—Minimum Funding Standards**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 467.—Certain Payments for the Use of Property or Services**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 468.—Special Rules for Mining and Solid Waste Reclamation and Closing Costs**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 482.—Allocation of Income and Deductions Among Taxpayers**

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 483.—Interest on Certain Deferred Payments**

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 642.—Special Rules for Credits and Deductions**

Federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

### **Section 704.—Partner's Distributive Share**

26 CFR 1.704-1: *Partner's distributive share.*

T.D. 9126

### **DEPARTMENT OF THE TREASURY Internal Revenue Service 26 CFR Part 1**

### **Section 704(b) and Capital Account Revaluations**

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the capital account maintenance rules under section 704 of the Internal Revenue Code. These regulations expand the rules regarding a partnership's right to adjust capital accounts to

reflect unrealized appreciation and depreciation in the value of partnership assets.

DATE: *Effective Date*: These regulations are effective May 6, 2004.

FOR FURTHER INFORMATION CONTACT: Laura Nash at (202) 622-3050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

### Background

On July 2, 2003, proposed regulations (REG-116914, 2003-32 I.R.B. 338 [68 FR 39498]) relating to the capital account maintenance rules under section 704 of the Internal Revenue Code (Code) were published in the **Federal Register**. The proposed regulations expanded the circumstances under which a partnership is permitted to increase or decrease the capital accounts of the partners to reflect a revaluation of partnership property on the partnership's books. Specifically, the regulations proposed to allow revaluations in connection with the grant of an interest in the partnership (other than a *de minimis* interest) on or after the date these final regulations are published in the **Federal Register** as consideration for the provision of services to or for the benefit of the partnership by an existing partner acting in a partner capacity, or by a new partner acting in a partner capacity or in anticipation of being a partner. In addition, the notice of proposed rulemaking requested comments on other situations in which revaluations of partnership property should be permitted. No written or electronic comments were received in response to the notice of proposed rulemaking. No requests for a public hearing were received, and accordingly, no hearing was held.

### Explanation of Provisions

This Treasury decision adopts the proposed regulations without change. The regulations apply to the grant of an interest in a partnership (other than a *de minimis* interest) on or after May 6, 2004, as consideration for the provision of services to or for the benefit of the partnership by an existing partner acting in a partner capacity, or by a new partner acting in a partner capacity or in anticipation of being a partner.

### Special Analysis

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

### Drafting Information

The principal author of these regulations is Laura Nash, Office of Associate Chief Counsel (Passthroughs and Special Industries), IRS. 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 1.704-1 is amended as follows:

1. Paragraph (b)(2)(iv)(f)(5)(iii) is redesignated as paragraph (b)(2)(iv)(f)(5)(iv).

2. New paragraph (b)(2)(iv)(f)(5)(iii) is added to read as follows:

*§1.704-1 Partner's distributive share.*

\* \* \* \* \*

(b) \* \* \*

(2) \* \* \*

(iv) \* \* \*

(f) \* \* \*

(5) \* \* \*

(iii) In connection with the grant of an interest in the partnership (other than a *de*

*minimis* interest) on or after May 6, 2004, as consideration for the provision of services to or for the benefit of the partnership by an existing partner acting in a partner capacity, or by a new partner acting in a partner capacity or in anticipation of being a partner.

\* \* \* \* \*

Mark E. Matthews,  
*Deputy Commissioner for  
Services and Enforcement.*

Approved April 29, 2004.

Gregory F. Jenner,  
*Assistant Secretary of the Treasury.*

(Filed by the Office of the Federal Register on May 5, 2004, 8:45 a.m., and published in the issue of the Federal Register for May 6, 2004, 69 F.R. 25315)

## Section 807.—Rules for Certain Reserves

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

## Section 846.—Discounted Unpaid Losses Defined

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

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

(Also sections 42, 280G, 382, 412, 467, 468, 482, 483, 642, 807, 846, 1288, 7520, 7872.)

**Federal rates; adjusted federal rates; adjusted federal long-term rate and the long-term exempt rate.** For purposes of sections 382, 642, 1274, 1288, and other sections of the Code, tables set forth the rates for June 2004.

## Rev. Rul. 2004-54

This revenue ruling provides various prescribed rates for federal income tax purposes for June 2004 (the current month). Table 1 contains the short-term, mid-term, and long-term applicable federal rates (AFR) for the current month for purposes of section 1274(d) of the

Internal Revenue Code. Table 2 contains the short-term, mid-term, and long-term adjusted applicable federal rates (adjusted AFR) for the current month for purposes of section 1288(b). Table 3 sets forth the adjusted federal long-term rate and the

long-term tax-exempt rate described in section 382(f). Table 4 contains the appropriate percentages for determining the low-income housing credit described in section 42(b)(2) for buildings placed in service during the current month. Finally,

Table 5 contains the federal rate for determining the present value of annuity, an interest for life or for a term of years, or a remainder or a reversionary interest for purposes of section 7520.

REV. RUL. 2004-54 TABLE 1				
Applicable Federal Rates (AFR) for June 2004				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
<i>Short-Term</i>				
AFR	1.98%	1.97%	1.97%	1.96%
110% AFR	2.18%	2.17%	2.16%	2.16%
120% AFR	2.37%	2.36%	2.35%	2.35%
130% AFR	2.58%	2.56%	2.55%	2.55%
<i>Mid-Term</i>				
AFR	3.89%	3.85%	3.83%	3.82%
110% AFR	4.28%	4.24%	4.22%	4.20%
120% AFR	4.67%	4.62%	4.59%	4.58%
130% AFR	5.07%	5.01%	4.98%	4.96%
150% AFR	5.86%	5.78%	5.74%	5.71%
175% AFR	6.85%	6.74%	6.68%	6.65%
<i>Long-Term</i>				
AFR	5.20%	5.13%	5.10%	5.08%
110% AFR	5.72%	5.64%	5.60%	5.57%
120% AFR	6.25%	6.16%	6.11%	6.08%
130% AFR	6.78%	6.67%	6.62%	6.58%

REV. RUL. 2004-54 TABLE 2				
Rates Under Section 382 for June 2004				
	<i>Period for Compounding</i>			
	<i>Annual</i>	<i>Semiannual</i>	<i>Quarterly</i>	<i>Monthly</i>
Short-term adjusted AFR	1.61%	1.60%	1.60%	1.59%
Mid-term adjusted AFR	3.06%	3.04%	3.03%	3.02%
Long-term adjusted AFR	4.62%	4.57%	4.54%	4.53%

REV. RUL. 2004-54 TABLE 3	
Rates Under Section 382 for June 2004	
Adjusted federal long-term rate for the current month	4.62%
Long-term tax-exempt rate for ownership changes during the current month (the highest of the adjusted federal long-term rates for the current month and the prior two months.)	4.62%



REV. RUL. 2004-54 TABLE 4

Appropriate Percentages Under Section 42(b)(2) for June 2004

Appropriate percentage for the 70% present value low-income housing credit	8.06%
Appropriate percentage for the 30% present value low-income housing credit	3.45%

REV. RUL. 2004-54 TABLE 5

Rate Under Section 7520 for June 2004

Applicable federal rate for determining the present value of an annuity, an interest for life or a term of years, or a remainder or reversionary interest	4.6%
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## Section 1288.—Treatment of Original Issue Discount on Tax-Exempt Obligations

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

## Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103: Confidentiality of returns.

**Clarification of scope of section 6103(a).** This ruling clarifies the fact that government employees who receive returns or return information pursuant to disclosures under section 6103(c), (k)(6), or (e) of the Code, other than section 6103(e)(1)(D)(iii) (relating to certain shareholders), are not subject to the disclosure restrictions of section 6103(a) with regard to the returns or return information received.

### Rev. Rul. 2004-53

#### ISSUE

Whether Federal, State and local government officers or employees (“government employees”) are subject to the disclosure restrictions of Internal Revenue Code section 6103(a) with regard to returns or return information received as a result of disclosures under:

- section 6103(c) with the consent of the taxpayer (taxpayer consent exception)

- section 6103(e) as a person having a material interest, but not under section 6103(e)(1)(D)(iii) relating to disclosures to certain shareholders (material interest exception), or
- section 6103(k)(6) for investigative purposes (investigative disclosure exception).

#### FACTS

*Situation 1.* A requests the assistance of his friend B with respect to a tax matter. A also requests that the Internal Revenue Service provide A’s returns and return information to B. B subsequently discloses to a third party returns and return information obtained as a result of A’s request that the Service provide the returns and return information.

*Situation 2.* Same as situation 1, above, except that B happens to be an employee in the office of a State agency.

*Situation 3.* C is a lawyer employed by a law firm. The firm has a policy of taking disciplinary action against any of its attorneys who do not properly fulfill their tax obligations. The Service serves a notice of levy with respect to C’s tax liability on the payroll department of the firm. A payroll department employee (D) processes the notice of levy and informs the firm’s managing partners of C’s tax delinquency to enable the firm to take appropriate action consistent with firm policy.

*Situation 4.* E is an employee of a State agency. The agency has a policy of taking disciplinary action against employees who do not properly fulfill their tax obligations. The Service serves a notice of levy with respect to E’s tax liability on the payroll department of the agency. A payroll depart-

ment employee (F) processes the notice of levy and informs the agency’s labor relations office of E’s tax delinquency to enable the agency to take appropriate action consistent with its policy.

*Situation 5.* Same as Situation 4, above, except that E and F are employees of a Federal agency.

*Situation 6.* G is the unemployed father of 5-year-old film star H. H’s mother signs H’s return as parent for a minor child and dies shortly thereafter. G is the guardian of H’s estate under applicable State law. G receives notice that H’s return is under examination. G does not have a copy of H’s return. To assist in the examination, G obtains the return and return information from the Service. When subsequently asked by a news reporter how much income H reported on the return, G replies “three million dollars.”

*Situation 7.* Same as Situation 6, above, except that G happens to be an employee of a Federal agency.

#### LAW

Generally, section 6103 provides that returns and return information (as defined in section 6103(b)(2)) are confidential and may not be disclosed except as expressly authorized by the Code. Specifically, except as authorized by the Code, section 6103(a) prohibits the disclosure by officers or employees of the United States, of any State, or of specified local government agencies, or by certain other specified persons, of returns and return information obtained in connection with service as such an officer or employee or otherwise. See *Girard v. Bentsen*, 94-2 U.S.T.C. ¶ 50,625 (N.D. Cal. 1994) (“or otherwise” modifies “in connection with his service”, allow-

ing the statute to cover those who are neither “officers” nor “employees”, namely certain other persons specified in section 6103(a)).

There are, however, exceptions to the general rule of confidentiality. First, the taxpayer consent exception permits the disclosure of returns and return information to a designee of a taxpayer, pursuant to the taxpayer’s request or consent. To be valid, a consent must satisfy the requirements of section 6103(c) and § 301.6103(c)-1(a) of the Procedure and Administration Regulations. Second, the material interest exception permits the disclosure of returns and return information to specific persons with a *material interest* in the information. Third, the investigative disclosure exception, in conjunction with § 301.6103(k)(6)-1, authorizes the disclosure of return information (but not returns) to the extent that disclosure is necessary in obtaining information that is not otherwise reasonably available with respect to the correct determination of tax, liability for tax, or the amount to be collected, or with respect to the enforcement of any other provision of the Code.

When the general rule of confidentiality applies, section 6103(p) imposes certain accountings and safeguards. Section 6103(p)(3) generally requires the Service to maintain a permanent system of standardized records or accountings of all requests for, and disclosures of, returns and return information under particular provisions of section 6103. Section 6103(p)(4) generally requires recipients of returns or return information under particular provisions of section 6103 to keep records of requests and disclosures, to maintain secure storage, to establish restricted access, to report to the Service on confidentiality procedures, to return or destroy the returns or return information upon completion of the prescribed use, and to provide other necessary or appropriate safeguards. These accounting and safeguard requirements do not apply to returns or return information

disclosed under the taxpayer consent exception, the material interest exception, or the investigative disclosure exception.

#### ANALYSIS

Section 6103(c), (e), and (k)(6) contains no limitation or restriction on the redisclosure of returns or return information received pursuant to the taxpayer consent, material interest and investigative disclosure exceptions. Therefore, in Situations 1, 3, and 6 there are no statutory or regulatory restrictions on the redisclosures made by *B*, *D*, or *G*.

In Situations 2, 4, 5, and 7, however, the prohibition in section 6103(a) on redisclosure by government employees could be read to prohibit redisclosures by *B*, *F*, and *G* because they happen to be government employees. This reading would create a disparity in the application of section 6103(a) based on where the person receiving the disclosure of returns or return information happens to be employed.

By its terms, section 6103(a) does not regulate or control the use of returns and return information received under the taxpayer consent, material interest and investigative disclosure exceptions. Moreover, the requirements for accountings and safeguards that typically apply where redisclosure is limited do not apply to these exceptions.

There is no evidence that Congress intended disparate treatment of individuals receiving disclosures of returns or return information pursuant to these exceptions merely because they happen to be government employees. On the contrary, there are compelling reasons for those government employees to be subject to the same rules as other recipients. For example, a private sector employer may take disciplinary action against employees who do not properly fulfill their tax obligations. If redisclosure is not permitted because the employer happens to be the Federal government, the Federal employees who failed to

fulfill their tax obligations would be in a significantly better position than their private sector counterparts. This inappropriate result only occurs if section 6103(a) is read to apply to individuals merely because they happen to be government employees.

Accordingly, persons are not barred because of their status as government employees from redisclosing returns and return information received pursuant to section 6103(c), (e), and (k)(6).

#### HOLDING

Government employees who receive returns or return information pursuant to disclosures under section 6103(c), (k)(6) or (e), other than section 6103(e)(1)(D)(iii) (relating to certain shareholders), are not subject to the disclosure restrictions of section 6103(a) with regard to the returns or return information received.

#### DRAFTING INFORMATION

The principal author of this revenue ruling is Geoffrey M. Campbell of the Office of Associate Chief Counsel, Procedure & Administration (Disclosure & Privacy Law Division). For further information regarding this revenue ruling, contact Geoffrey M. Campbell at (202) 622-4570 (not a toll-free call).

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### Section 7520.—Valuation Tables

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

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

The adjusted applicable federal short-term, mid-term, and long-term rates are set forth for the month of June 2004. See Rev. Rul. 2004-54, page 1024.

# Part III. Administrative, Procedural, and Miscellaneous

## Weighted Average Interest Rates Update

### Notice 2004-40

This notice provides guidance as to the corporate bond weighted average interest rate and the permissible range of interest rates specified under § 412(b)(5)(B)(ii)(II) of the Internal Revenue Code. In addition, it provides guidance as to the interest rate on 30-year Treasury securities under § 417(e)(3)(A)(ii)(II), and the weighted average interest rate and permissible ranges of interest rates based on the 30-year Treasury securities rate.

### CORPORATE BOND WEIGHTED AVERAGE INTEREST RATE

Sections 412(b)(5)(B)(ii) and 412(l)(7)(C)(i), as amended by the Pension Funding Equity Act of 2004, provide that the interest rates used to calculate current liability and to determine the required contribution under § 412(l) for plan years beginning in 2004 or 2005 must be within a permissible range based on the weighted average of the rates of interest on amounts invested conservatively in long term investment grade corporate bonds during the 4-year period ending on the last day before the beginning of the plan year.

Notice 2004-34, 2004-18 I.R.B. 848, provides guidelines for determining the

corporate bond weighted average interest rate and the resulting permissible range of interest rates used to calculate current liability. That notice establishes that the corporate bond weighted average is based on the monthly composite corporate bond rate derived from designated corporate bond indices.

The composite corporate bond rate for April 2004 is 5.86 percent. Pursuant to Notice 2004-34, the Service has determined this rate as the average of the monthly yields for the included corporate bond indices for that month.

The following corporate bond weighted average interest rate was determined for plan years beginning in the month shown below.

For Plan Years Beginning in:		Corporate Bond Weighted Average	90% to 100% Permissible Range
Month	Year		
May	2004	6.36	5.73 to 6.36

### 30-YEAR TREASURY SECURITIES WEIGHTED AVERAGE INTEREST RATE

Section 417(e)(3)(A)(ii)(II) defines the applicable interest rate, which must be used for purposes of determining the minimum present value of a participant's benefit under § 417(e)(1) and (2), as the annual rate of interest on 30-year Treasury securities for the month before the date of distribution or such other time as the Secretary may by regulations prescribe. Section 1.417(e)-1(d)(3) of the Income

Tax Regulations provides that the applicable interest rate for a month is the annual interest rate on 30-year Treasury securities as specified by the Commissioner for that month in revenue rulings, notices or other guidance published in the Internal Revenue Bulletin.

Section 404(a)(1) of the Code, as amended by the Pension Funding Equity Act of 2004, permits an employer to elect to disregard subclause (II) of § 412(b)(5)(B)(ii) to determine the max-

imum amount of the deduction allowed under § 404(a)(1).

The rate of interest on 30-year Treasury securities for April 2004 is 5.14 percent. Pursuant to Notice 2002-26, 2002-1 C.B. 743, the Service has determined this rate as the monthly average of the daily determination of yield on the 30-year Treasury bond maturing in February 2031.

The following 30-year Treasury rates were determined for the plan years beginning in the month shown below.

For Plan Years Beginning in:		30-Year Treasury Weighted Average	90% to 105% Permissible Range	90% to 110% Permissible Range
Month	Year			
May	2004	5.17	4.65 to 5.43	4.65 to 5.69

### Drafting Information

The principal authors of this notice are Paul Stern and Tony Montanaro of the Employee Plans, Tax Exempt and Government Entities Division. For further information regarding this notice,

please contact the Employee Plans' taxpayer assistance telephone service at 1-877-829-5500 (a toll-free number), between the hours of 8:00 a.m. and 6:30 p.m. Eastern time, Monday through Friday. Mr. Stern may be reached at 1-202-283-9703. Mr. Montanaro may

be reached at 1-202-283-9714. The telephone numbers in the preceding sentences are not toll-free.

## Rev. Proc. 2004-35

### SECTION 1. PURPOSE

This revenue procedure provides automatic relief for certain taxpayers requesting relief for late shareholder consents for S corporation elections in community property states.

### SECTION 2. BACKGROUND

Section 1361(a)(1) of the Internal Revenue Code defines an "S corporation," with respect to any taxable year, as a small business corporation for which an S corporation election under section 1362(a) is in effect for that year.

Section 1362(a)(2) provides that an election to be an S corporation shall be valid only if all persons who are shareholders in the corporation on the day on which the election is made consent to the election.

Section 1.1362-6(b)(2)(i) of the Income Tax Regulations provides that when stock of the corporation is owned by husband and wife as community property (or the income from the stock is community property), each person having a community interest in the stock or income therefrom must consent to the election.

Section 1.1362-6(b)(3)(iii) provides that an election that is timely filed for any taxable year and that would be valid except for the failure of any shareholder to file a timely consent is not invalid if consents are filed and it is shown to the satisfaction of the service center with which the corporation files its income tax return that (1) there was reasonable cause for the failure to file the consent, (2) the request for the extension of time to file a consent is made within a reasonable time under the circumstances, and (3) the interests of the Government will not be jeopardized by treating the election as valid.

### SECTION 3. SCOPE

This revenue procedure provides automatic relief for late filing of share-

holder consents for spouses of S corporation shareholders in community property states.

A corporation that does not meet the requirements for relief or is denied relief under this revenue procedure may request relief under § 1.1362-6(b)(3)(iii). The corporation may also request inadvertent invalid election relief by requesting a letter ruling. The procedural requirements for requesting a letter ruling are described in Rev. Proc. 2004-1, 2004-1 I.R.B. 1 (or its successor).

### SECTION 4. AUTOMATIC RELIEF FOR LATE SHAREHOLDER CONSENTS UNDER THIS REVENUE PROCEDURE

.01 *Eligibility for Automatic Relief.* Automatic relief is available if all of the following conditions are met:

(1) The S corporation election is invalid solely because the Form 2553, *Election by a Small Business Corporation*, failed to include the signature of a community property spouse who was a shareholder solely pursuant to state community property law; and

(2) Both spouses have reported all items of income, gain, loss, deduction or credit consistent with the S corporation election on all affected federal income tax returns.

.02 *Procedural Requirements for Automatic Relief.* The corporation must file with the service center with which the corporation files its income tax return a dated statement that includes the following information:

(1) A representation that reads, "This statement is being furnished pursuant to Rev. Proc. 2004-35 for a late filing of shareholder consents for community property spouses of S corporation shareholders in community property states."

(2) The name of the corporation, its employer identification number, its address, date of incorporation, state of incorporation, and the intended effective date of its initially filed Form 2553;

(3) Each spouse's name, social security number or employee identification number, tax year end and the total number of shares owned at the date of the intended election;

(4) A statement that the community property spouses reported all items of

income, gain, loss, deduction or credit consistent with the S corporation election on all affected returns;

(5) A signed statement from each of the community property spouses that reads, "Under penalties of perjury, I, [name of community property spouse], declare that I consent to the election to treat [name of S corporation] to be an S corporation under section 1362(a) of the Internal Revenue Code as of [the date that the S corporation intended to be an S corporation] and to the best of my knowledge and belief, the facts presented in support of this election are true, correct, and complete."

.03 *Relief for Failure to File Timely Shareholder Consent to S Corporation Elections.* A shareholder that satisfies the requirements of section 4.01 of this revenue procedure will be deemed (1) to have reasonable cause for the failure to consent to the S corporation elections, (2) to have made the request for the extension of time to file a consent within a reasonable time under the circumstances, and (3) to have satisfied the requirement that the interests of the Government will not be jeopardized by treating the election as valid. Accordingly, the shareholder will automatically be granted relief to file the late shareholder consent. The Service will notify the shareholder of the acceptance of the shareholder's request to file the late shareholder consent or of the denial of a request that fails to satisfy the requirements of this revenue procedure.

### SECTION 5. EFFECTIVE DATE

This revenue procedure is effective for all applications for relief satisfying the requirements of section 4 of this revenue procedure, including those applications now being considered by the Service.

### SECTION 6. 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 1545-1886.

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 collections of information in this revenue procedure are in section 4.02. This information is required to be submitted to the applicable service center in order to obtain relief for late elections under subchapter S. This information will be used to determine whether the eligibility requirements for obtaining relief have been met. The collection of information is required to obtain a benefit. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting burden is 500 hours.

The estimated annual burden per respondent varies from .5 hours to 7 hours, depending on individual circumstances, with an estimated average burden of 1 hour to complete the statement. The estimated number of respondents is 200.

The estimated annual frequency of responses is on occasion.

Books or records relating to a collection of information must be retained as long as their contents may become material in the administration of any internal revenue law. Generally tax returns and tax return

information are confidential, as required by 26 U.S.C. 6103.

#### SECTION 7. DRAFTING INFORMATION

The principal author of this revenue procedure is Jason T. Smyczek of the Office of the Associate Chief Counsel (Passthroughs and Special Industries.) For further information regarding this revenue procedure, contact Mr. Smyczek at (202) 622-3050 (not a toll-free call).

## Part IV. Items of General Interest

### Notice of Proposed Rulemaking and Notice of Public Hearing

### Definition of Solid Waste Disposal Facilities for Tax-Exempt Bond Purposes

#### REG-140492-02

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: This document contains proposed regulations on the definition of solid waste disposal facilities for purposes of the rules applicable to tax-exempt bonds issued by State and local governments. These regulations provide guidance to State and local governments that issue tax-exempt bonds to finance solid waste disposal facilities and to taxpayers that use those facilities. This document also contains a notice of public hearing on these proposed regulations.

DATES: Written or electronic comments must be received by August 9, 2004. Outlines of topics to be discussed at the public hearing scheduled for August 11, 2004, at 10 a.m., must be received by August 4, 2004.

ADDRESSES: Send submissions to CC:PA:LPD:PR (REG-140492-02), room 5203, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-140492-02), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically to the IRS Internet site at <http://www.irs.gov/regs>, or via the Federal eRulemaking Portal at <http://www.regulations.gov> (IRS — REG-140492-02). The public hearing will be held in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Michael P. Brewer, (202) 622-3980; concerning submissions and the hearing, Sonya Cruse, (202) 622-4693 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### Background

Generally, interest on a State or local bond is excluded from gross income under section 103 of the Internal Revenue Code (Code). However, section 103(b) provides that the exclusion does not apply to a private activity bond unless the bond is a qualified bond. Section 141(e) defines *qualified bond* to include an exempt facility bond that meets certain requirements. Section 142(a) lists the categories of exempt facility bonds, which include bonds for solid waste disposal facilities under section 142(a)(6).

Section 1.103-8(f)(2)(ii)(a) of the Income Tax Regulations generally defines *solid waste disposal facilities* as any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. Section 1.103-8(f)(2)(ii)(b) provides that the term *solid waste* has the same meaning as in former section 203(4) of the Solid Waste Disposal Act (42 U.S.C. 3252(4)), as quoted in §1.103-8(f)(2)(ii)(b), except that material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the facility to dispose of the waste material, it is property that is useless, unused, unwanted, or discarded solid material that has no market or other value at the place where the property is located (the *no-value test*). Thus, under the existing regulations, when any person is willing to purchase the property, at any price, the material is not waste. However, if any person is willing to remove the property at his own expense but is not willing to purchase it at any price, the material is waste under the existing regulations.

Former section 203(4) of the Solid Waste Disposal Act, as quoted in §1.103-8(f)(2)(ii)(b), provides that the term *solid waste* means,

garbage, refuse, and other discarded solid materials, including solid-waste

materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants.

Section 1.103-8(f)(2)(ii)(c) states that a facility that disposes of solid waste by reconstituting, converting, or otherwise recycling it into material that is not waste also qualifies as a solid waste disposal facility if solid waste constitutes at least 65 percent, by weight or volume, of the total materials introduced into the recycling process. Such a recycling facility does not fail to qualify as a solid waste disposal facility under the existing regulations solely because it operates at a profit.

Section 17.1(a) of the temporary Income Tax Regulations generally provides that, in the case of property that has both a solid waste disposal function and a function other than the disposal of solid waste, only the portion of the cost of the property allocable to the function of solid waste disposal is taken into account as an expenditure to provide solid waste disposal facilities. However, under §17.1(a), a facility that otherwise qualifies as a solid waste disposal facility will not be treated as having a function other than solid waste disposal merely because material or heat that has utility or value is recovered or results from the disposal process. Section 17.1(a) provides that, when materials or heat are recovered, the waste disposal function includes the processing of those materials or heat that occurs in order to put them into the form in which the materials or heat are in fact sold or used, but does not include further processing that converts the materials or heat into other products.

Section 17.1(b) provides that the portion of the cost of property allocable to solid waste disposal is determined by allocating the cost of the property between the property's solid waste disposal function and any other functions by any method which, with reference to all the facts and circumstances with respect to the property,

reasonably reflects a separation of costs for each function of the property.

In Notice 2002-51, 2002-2 C.B. 131, the IRS and Treasury Department requested public comments on the application of section 142(a)(6) to recycling facilities. Notice 2002-51 also invited comments on any other issues concerning the application of that Code provision.

In response to the Notice, commentators suggested that the rules governing exempt facility bonds for solid waste disposal facilities should be consistent with national policies to encourage, facilitate, and increase recycling. For example, commentators stated that the rules should not deny tax-exempt financing to recycling while providing such financing to landfills and municipal waste incinerators.

Commentators suggested revisions to the no-value test used for determining whether material is solid waste. For example, commentators suggested that material that has a market or other value at the place it is located only by reason of its value for recycling should not be considered to have a market or other value. Commentators also suggested that material acquired by a recycler should qualify as solid waste if the amounts paid to the packer, collector or similar party are not in excess of the cost of transporting and handling the material. Some commentators suggested that the determination of whether material is waste should be made at the point of generation prior to the time costs are incurred to divert the material from the waste stream.

Commentators also suggested that the determination of when the waste recycling process stops should not depend on whether the activity is being carried out by a single party or multiple parties, or whether there has been a change of ownership of the material.

The IRS and Treasury Department have considered these comments, and the proposed regulations contained in this document (the proposed regulations) implement a number of these recommendations.

## Explanation of Provisions

### I. Solid Waste

The proposed regulations contain proposed amendments to 26 CFR part 1 regarding exempt facility bonds for solid waste disposal facilities. In light of the

changes that have occurred in the waste recycling industry since the existing regulations were issued in 1972, the proposed regulations eliminate the no-value test for determining whether material is solid waste. The proposed regulations retain the definition of solid waste under former section 203(4) of the Solid Waste Disposal Act, quoted above, and provide guidance for determining whether material constitutes “garbage, refuse and other discarded solid materials” under that definition.

Thus, the proposed regulations provide that the term *solid waste* means garbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants.

For these purposes, the proposed regulations provide that *garbage, refuse and other discarded solid materials* means material that is solid and that is introduced into a final disposal process, conversion process, recovery process, or transformation process (as those terms are defined in the proposed regulations and described in part II below) unless the material falls within one of several categories of excluded items.

The first category of material that does not constitute solid waste is material that is introduced into a conversion process if the material is either: (1) a fossil fuel; or (2) any material that is grown, harvested, produced, mined, or otherwise created for the principal purpose of converting the material to heat, hot water, steam, or another useful form of energy. For this purpose, material is not treated as grown, harvested, produced, mined, or otherwise created for the principal purpose of converting the material to heat, hot water, steam, or another useful form of energy just because an operation is performed on the material to make the material more conducive to being converted to heat, hot water, or steam. For example, if material that is not otherwise grown, harvested, produced, mined, or created for the principal purpose of converting the material to a useful form of en-

ergy is formed into pellets to make the material more conducive to being incinerated to produce steam, the creation of pellets does not cause the material to be produced or created for the principal purpose of converting the material to steam.

The second category of material that does not constitute solid waste is any precious metal that is introduced into a recovery process.

The regulations are reserved with respect to any additional category of excluded material that may be specified with respect to a transformation process.

Under the proposed regulations, hazardous material is not solid waste if the material is disposed of at a facility that is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on October 22, 1986, the date of the enactment of the Tax Reform Act of 1986). Thus, under the proposed regulations, a hazardous waste disposal facility described in section 142(h)(1) would not qualify as a solid waste disposal facility.

Finally, the proposed regulations provide that radioactive material is not solid waste.

## II. Solid Waste Disposal Facility

### A. In General

The proposed regulations provide that a facility is a *solid waste disposal facility* to the extent that the facility is: (1) used to perform a solid waste disposal function (as defined in the proposed regulations and discussed in part II, B below); (2) used to perform a preliminary function (as defined in the proposed regulations and discussed in part II, C below); or (3) functionally related and subordinate (within the meaning of §1.103-8(a)(3)) to a facility that is used to perform a solid waste disposal function or a preliminary function.

### B. Solid Waste Disposal Function

The proposed regulations define *solid waste disposal function* as the processing of solid waste in (1) a final disposal process, (2) a conversion process, (3) a recovery process, or (4) a transformation process.

### 1. Final Disposal Process

Under the proposed regulations, a *final disposal process* is (1) the placement of material in a landfill or (2) the incineration of material without any useful energy being captured. Comments are requested on whether other types of processes should be included in the definition of final disposal process.

### 2. Conversion Process

The proposed regulations define *conversion process* as a process in which material is incinerated and heat, hot water, or steam is created and captured as useful energy. For this purpose, the conversion process begins with the incineration of material and ends at the point at which the latest of heat, hot water, or steam is created. Thus, the conversion process ends before any transfer or distribution of heat, hot water or steam. Comments are requested on the definition of conversion process in the proposed regulations, including whether the definition should include processes in which useful energy in a form other than heat, hot water, or steam is created.

### 3. Recovery Process

The proposed regulations define *recovery process* as a process that starts with the melting or re-pulping of material to return the material to a form in which the material previously existed for use in the fabrication of an end product and ends immediately before the material is processed in the same or substantially the same way that virgin material is processed to fabricate the end product.

The proposed regulations further provide that, if an end product is fabricated entirely from non-virgin material, the recovery process ends immediately before the non-virgin material is processed in the same or substantially the same way that virgin material is processed in a comparable fabrication process that uses only virgin material or a combination of virgin and non-virgin material.

The proposed regulations also specify that refurbishing, repair, or similar activities are not recovery processes.

Comments are requested on the definition of recovery process in the proposed regulations, including whether the definition should include processes, other than

melting or re-pulping, that return material to a form in which the material previously existed.

### 4. Transformation Process

The IRS and Treasury Department recognize that certain processes in which material is transformed for use in the creation of a useful product (*transformation processes*) should be treated as solid waste disposal functions. A transformation process could include, for example, shredding used tires for use as roadbed material. However, defining a transformation process requires clear criteria that distinguish a transformation process from a manufacturing or production process that uses material other than solid waste. The proposed regulations reserve on the definition of transformation process so that the public may comment on how the definition should be crafted to meet this objective within the context of the proposed regulations. Comments are requested in particular on whether the definition of a transformation process should be limited to the processing of particular types of materials to produce certain categories of products, and, if so, what types of materials and which categories of products should be included.

### C. Preliminary Function

A facility is a solid waste disposal facility under the proposed regulations to the extent that the facility is used to perform a preliminary function. For this purpose, a *preliminary function* is the collection, separation, sorting, storage, treatment, processing, disassembly, or handling of solid material that is preliminary and directly related to a solid waste disposal function. However, no portion of a collection, separation, sorting, storage, treatment, processing, disassembly, or handling activity is a preliminary function unless, for each year while the issue is outstanding, more than 50 percent, by weight or volume, of the total materials that result from the entire activity (both the part that is preliminary and directly related to a solid waste disposal function and the part that is not preliminary and directly related to a solid waste disposal function) is solid waste. For example, if a facility sorts material and some of the sorted material is processed in a solid waste disposal function and some of

the sorted material is processed in another manner, a portion of the sorting facility is a solid waste disposal facility if, for each year while the issue is outstanding, more than 50 percent, by weight or volume, of all the sorted material is solid waste.

### D. Mixed-Function Facilities

The proposed regulations provide that, in general, if a facility is used to perform both (1) a solid waste disposal function or a preliminary function, and (2) another function, then the costs of the facility allocable to the solid waste disposal function or the preliminary function are determined using any reasonable method, based on all the facts and circumstances. This rule applies, for example, if a facility is used (1) to process solid waste in a recovery process and (2) to perform another function that is neither a solid waste disposal function (because it does not process solid waste in a final disposal process, conversion process, recovery process, or transformation process) nor a preliminary function (because it is not preliminary and directly related to a solid waste disposal function).

The proposed regulations also contain a special rule to determine the portion of the costs of property that are allocable to a solid waste disposal function if the property is used to perform a final disposal process, conversion process, recovery process, or transformation process and the inputs to the process consist of solid waste and material that is not solid waste. Under this special rule, the portion of the costs of property used to perform such a process that are allocable to a solid waste disposal function equals the lowest percentage of solid waste processed in the process in any year while the issue is outstanding. The percentage of solid waste processed in such a process for any year is the percentage, by weight or volume, of the total materials processed in the process that constitute solid waste for that year. If, however, for each year while the issue is outstanding, solid waste constitutes at least 80 percent, by weight or volume, of the total materials processed in the process, all of the costs of the property used to perform the process are allocable to a solid waste disposal function.



## Proposed Effective Date

The proposed regulations will apply to bonds that are: (1) sold on or after the date that is 60 days after the date of publication of final regulations under section 142(a)(6) in the **Federal Register**; and (2) subject to section 142. However, the proposed regulations provide that an issuer is not required to apply the regulations to bonds described in the preceding sentence that are issued to refund a bond to which the regulations do not apply if the weighted average maturity of the refunding bonds is not longer than the weighted average maturity of the refunded bonds. Section 1.103-8(f)(2) of the Income Tax Regulations and §17.1 of the temporary Income Tax Regulations will not apply to bonds that are subject to the final regulations under section 142(a)(6).

## Special Analyses

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

## Comments and Public Hearing

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

A public hearing has been scheduled for August 11, 2004, at 10 a.m. in the auditorium, Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC. Due to building security procedures,

visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the lobby more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the FOR FURTHER INFORMATION CONTACT section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit written comments by August 9, 2004, and submit an outline of the topics to be discussed and the amount of time to be devoted to each topic by August 4, 2004.

A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Comments are requested on all aspects of the proposed regulations, including those aspects for which specific requests for comments are set forth above.

## Drafting Information

The principal authors of these regulations are Michael P. Brewer, Timothy L. Jones and Rebecca L. Harrigal, Office of Chief Counsel, IRS (TE/GE). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

## Proposed Amendments to the Regulations

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

### PART 1—INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:  
Authority: 26 U.S.C. 7805 \* \* \*

Par. 2. Section 1.142(a)(6)–1 is added to read as follows:

### §1.142(a)(6)–1 Exempt facility bonds: solid waste disposal facilities.

(a) *In general.* Section 103(a) provides that, generally, interest on a state or local bond is not included in gross income. However, this exclusion does not apply to any private activity bond that is not a qualified bond. Section 141(e) defines *qualified bond* to include an exempt facility bond that meets certain requirements. Section 142(a) defines *exempt facility bond* as any bond issued as part of an issue 95 percent or more of the net proceeds of which are to be used to provide a facility specified in section 142(a). One type of facility specified in section 142(a) is a solid waste disposal facility. This section defines the term solid waste disposal facility for purposes of section 142(a).

(b) *Solid waste disposal facility*—(1) *In general.* The term *solid waste disposal facility* means a facility to the extent that the facility is—

(i) Used to perform a solid waste disposal function (within the meaning of paragraph (b)(2) of this section);

(ii) Used to perform a preliminary function (within the meaning of paragraph (b)(3) of this section); or

(iii) Functionally related and subordinate (within the meaning of §1.103-8(a)(3)) to a facility that is used to perform a solid waste disposal function or a preliminary function.

(2) *Solid waste disposal function.* A solid waste disposal function is the processing of solid waste (as defined in paragraph (c) of this section) in—

(i) A final disposal process (as defined in paragraph (d) of this section);

(ii) A conversion process (as defined in paragraph (e) of this section);

(iii) A recovery process (as defined in paragraph (f) of this section); or

(iv) A transformation process (as defined in paragraph (g) of this section).

(3) *Preliminary function.* A preliminary function is the collection, separation, sorting, storage, treatment, processing, disassembly, or handling of solid material that is preliminary and directly related to a solid waste disposal function. However, no portion of a collection, separation, sorting, storage, treatment, processing, disassembly, or handling activity is a preliminary function unless, for each year while the issue is outstanding, more than

50 percent, by weight or volume, of the total materials that result from the entire activity is solid waste.

(4) *Mixed-function facilities.* Paragraph (h) of this section provides rules for determining the portion of a facility that is a solid waste disposal facility for a facility that is used to perform—

(i) A solid waste disposal function or a preliminary function; and

(ii) Another function.

(c) *Solid Waste*—(1) *In general.* For purposes of this section, the term *solid waste* means garbage, refuse, and other discarded solid materials (as defined in paragraph (c)(2) of this section), including solid waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants. Liquid or gaseous waste is not solid waste.

(2) *Garbage, refuse and other discarded solid materials*—(i) *In general.* For purposes of paragraph (c)(1) of this section, *garbage, refuse and other discarded solid materials* means material that is solid and that is introduced into a final disposal process, conversion process, recovery process, or transformation process unless the material is described in paragraph (c)(2)(ii), (iii), (iv), (v) or (vi) of this section.

(ii) *Certain material introduced into a conversion process.* Material is described in this paragraph (c)(2)(ii) if the material is introduced into a conversion process and the material is—

(A) A fossil fuel; or

(B) Any material that is grown, harvested, produced, mined, or otherwise created for the principal purpose of converting the material to heat, hot water, steam, or another useful form of energy. For example, organic material that is closed-loop biomass under section 45(c) is described in this paragraph (c)(2)(ii) if the material is introduced into a conversion process. Material is not treated as described in this paragraph (c)(2)(ii) just because an operation is performed on the material to make the material more conducive to being converted to heat, hot water, or steam.

For example, if material that is not otherwise grown, harvested, produced, mined, or created for the principal purpose of converting the material to a useful form of energy is formed into pellets to make the material more conducive to being incinerated to produce steam, the creation of pellets does not cause the material to be produced or created for the principal purpose of converting the material to steam.

(iii) *Certain material introduced into a recovery process.* Material is described in this paragraph (c)(2)(iii) if the material is introduced into a recovery process, and the material is a precious metal.

(iv) *Certain material introduced into a transformation process.* [Reserved].

(v) *Certain hazardous material.* Material is described in this paragraph (c)(2)(v) if the material is hazardous material and it is disposed of at a facility that is subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on October 22, 1986, the date of the enactment of the Tax Reform Act of 1986). See section 142(h)(1).

(vi) *Radioactive material.* Material is described in this paragraph (c)(2)(vi) if the material is radioactive.

(d) *Final disposal process.* The term *final disposal process* means—

(1) The placement of material in a landfill; or

(2) The incineration of material without any useful energy being captured.

(e) *Conversion process.* The term *conversion process* means a process in which material is incinerated and heat, hot water, or steam is created and captured as useful energy. The conversion process begins with the incineration of material and ends at the point at which the latest of heat, hot water, or steam is created. Thus, the conversion process ends before any transfer or distribution of heat, hot water or steam.

(f) *Recovery process*—(1) *In general.* The term *recovery process* means a process that starts with the melting or re-pulping of material to return the material to a form in which the material previously existed for use in the fabrication of an end product and ends immediately before the material is processed in the same or substantially the same way that virgin material is processed to fabricate the end product. For example, melting non-virgin metal to fabricate a metal product is not a recovery process if virgin metal is melted in the same or sub-

stantially the same process to fabricate the product.

(2) *End products fabricated entirely from non-virgin material.* If an end product is fabricated entirely from non-virgin material, the recovery process ends immediately before the non-virgin material is processed in the same or substantially the same way that virgin material is processed in a comparable fabrication process that uses only virgin material or a combination of virgin and non-virgin material. For example, if new paper is fabricated entirely from re-pulped, non-virgin material, the recovery process ends immediately before the non-virgin material is processed in the same or substantially the same manner that virgin material is processed in the fabrication of paper made only with virgin material, or with a mixture of virgin and non-virgin material.

(3) *Refurbishing, repair, or similar activities.* Refurbishing, repair, or similar activities are not recovery processes.

(g) *Transformation process.* [Reserved].

(h) *Mixed-function facilities*—(1) *In general.* Except to the extent provided in paragraph (h)(2) of this section, if a facility is used to perform both a solid waste disposal function or a preliminary function and another function, then the costs of the facility allocable to the solid waste disposal function or the preliminary function are determined using any reasonable method, based on all the facts and circumstances. See §1.103-8(a)(1) for rules relating to which amounts are used to provide an exempt facility.

(2) *Mixed inputs*—(i) *In general.* Except as provided in paragraph (h)(2)(ii) of this section, for each final disposal process, conversion process, recovery process, or transformation process, the percentage of costs of the property used to perform such process that are allocable to a solid waste disposal function equals the lowest percentage of solid waste processed in that process in any year while the issue is outstanding. The percentage of solid waste processed in such process for any year is the percentage, by weight or volume, of the total materials processed in that process that constitute solid waste for that year.

(ii) *Special rule for mixed-input processes if at least 80 percent of the materials processed are solid waste.* For each final

disposal process, conversion process, recovery process, or transformation process, all of the costs of the property used to perform such process are allocable to a solid waste disposal function if, for each year while the issue is outstanding, solid waste constitutes at least 80 percent, by weight or volume, of the total materials processed in the process.

(i) *Examples.* The following examples illustrate the application of this section:

*Example 1. Final disposal process.* Garbage trucks collect solid material at curbside from businesses and residences and dump the material in a landfill owned by Company A. The landfill is not subject to final permit requirements under subtitle C of title II of the Solid Waste Disposal Act (as in effect on the date of the enactment of the Tax Reform Act of 1986). The placement of material in the landfill is a final disposal process. The solid material placed in the landfill is solid waste under paragraph (c) of this section. Therefore, the landfill is a solid waste disposal facility.

*Example 2. Recovery process.* Company B re-pulps magazines and cleans the pulp. After cleaning, B mixes the pulp with virgin material and uses the mixed material to produce rolls of paper towels. Before the mixing, the re-pulped material is not processed in the same or substantially the same way that virgin material is processed to produce the paper towels. The process starting with the re-pulping of the magazines and ending immediately before the re-pulped material is mixed with the virgin material is a recovery process. The magazines introduced into the recovery process are solid waste. Therefore, the property that re-pulps the magazines and the property that cleans the re-pulped material are used to perform a solid waste disposal function.

*Example 3. Preliminary function.* Company C owns a paper mill. At the mill, logs from nearby timber operations are processed through a machine that

removes bark. The stripped logs are used to manufacture paper. The stripped bark falls onto a conveyor belt that transports the bark to a storage bin used to briefly store the bark until C feeds the bark into a boiler. The conveyor belt and storage bin are used only for these purposes. The boiler is used only to create steam by burning the bark, and the steam is used to generate electricity. The creation of steam from the stripped bark is a conversion process that starts with the incineration of the stripped bark. The conversion process is a solid waste disposal function. The conveyor belt performs a collection activity that is preliminary and that is directly related to the solid waste disposal function. The storage bin performs a storage function that is preliminary and that is directly related to the solid waste disposal function. Thus, the conveyor belt and storage bin are solid waste disposal facilities. The removal of the bark does not have a sufficient nexus to the conversion process to be directly related to the conversion process; the process of removing the bark does not become directly related to the conversion process merely because it results in material that will be waste used in the conversion process.

*Example 4. Mixed-input facility.* Company D owns an incinerator financed by an issue and uses the incinerator exclusively to burn coal (a fossil fuel) and other solid material to create steam that is used to generate electricity. Each year while the issue is outstanding, 30 percent by volume and 40 percent by weight of the solid material that D processes in the conversion process is a fossil fuel. The remainder of the solid material processed is neither a fossil fuel nor material that was grown, harvested, produced, mined, or otherwise created for the principal purpose of converting the material to heat, hot water, steam, or another useful form of energy. Seventy percent of the costs of the property used to perform the conversion process are allocable to a solid waste disposal function.

*Example 5. Mixed-function facility.* Company E owns and operates a facility financed by an issue and uses the facility exclusively to sort damaged bottles

from bottles that may be re-filled. The damaged bottles are directly introduced into a process that melts them for use in the fabrication of an end product. The melting process is a recovery process. Each year while the issue is outstanding, more than 50 percent, by weight or volume, of all of the bottles that pass out of the sorting process are damaged bottles that are processed in a recovery process. The sorting facility performs a preliminary function, but it also performs another function. The costs of the sorting facility allocable to the preliminary function are determined using any reasonable method, based on all the facts and circumstances.

(j) *Effective date*—(1) *In general.* Except as provided in paragraph (j)(2) of this section, this section applies to bonds that are—

(i) Sold on or after the date that is 60 days after the date of publication of final regulations in the **Federal Register**; and

(ii) Subject to section 142.

(2) *Certain refunding bonds.* An issuer is not required to apply this section to bonds described in paragraph (j)(1) of this section that are issued to refund a bond to which this section does not apply if the weighted average maturity of the refunding bonds is not longer than the weighted average maturity of the refunded bonds.

Mark E. Matthews,  
Deputy Commissioner for  
Services and Enforcement.

(Filed by the Office of the Federal Register on May 5, 2004, 2:45 p.m., and published in the issue of the Federal Register for May 10, 2004, 69 F.R. 25856)

## Announcement of Disciplinary Actions Involving Attorneys, Certified Public Accountants, Enrolled Agents, and Enrolled Actuaries — Suspensions, Censures, Disbarments, and Resignations

### Announcement 2004-49

Under Title 31, Code of Federal Regulations, Part 10, attorneys, certified public accountants, enrolled agents, and enrolled actuaries may not accept assistance from, or assist, any person who is under disbarment or suspension from practice before the Internal Revenue Service if the assistance relates to a matter constituting practice before the Internal Revenue Service and may not knowingly aid or abet another

person to practice before the Internal Revenue Service during a period of suspension, disbarment, or ineligibility of such other person.

To enable attorneys, certified public accountants, enrolled agents, and enrolled actuaries to identify persons to whom these restrictions apply, the Director, Office of Professional Responsibility, will announce in the Internal Revenue Bulletin

their names, their city and state, their professional designation, the effective date of disciplinary action, and the 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.

# Consent Disbarments From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice be-

fore the Internal Revenue Service, may offer his or her consent to disbarment from such practice. The Director, Office of Professional Responsibility, in his discretion, may disbar an attorney, certified public ac-

countant, enrolled agent, or enrolled actuary in accordance with the consent offered.

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

Name	Address	Designation	Date of Disbarment
Ranes III, Wesse C.	Annapolis, MD	CPA	Indefinite from May 1, 2004

# Consent Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent, or enrolled actuary, in order to avoid institution or conclusion of a proceeding for his or her disbarment or suspension from practice be-

fore the Internal Revenue Service, may offer his or her consent to suspension from such practice. The Director, Office of Professional Responsibility, in his discretion, may suspend an attorney, certified public accountant, enrolled agent, or enrolled ac-

tuary in accordance with the consent offered.

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

Name	Address	Designation	Date of Suspension
Montgomery, Goldie L.	Lancaster, CA	Enrolled Agent	Indefinite from February 1, 2004
Frost, Charles L.	San Antonio, TX	Enrolled Agent	Indefinite from February 1, 2004
Briggs, John W.	Sayville, NY	Enrolled Agent	February 10, 2004 from August 8, 2004
Lahman, Gary M.	Ft. Collins, CO	Enrolled Agent	Indefinite from February 12, 2004
Stanny, Gertrude M.	South Lyon, MI	Enrolled Agent	Indefinite from March 1, 2004

Name	Address	Designation	Date of Suspension
Millar, Mark	Tall Timbers, MD	Enrolled Agent	Indefinite from March 1, 2004
Murray, Maureen E.	Naugatuck, CT	Enrolled Agent	Indefinite from March 1, 2004
Keith, James S.	Imperial Beach, CA	Enrolled Agent	March 2, 2004 from June 30, 2004
Zelek, Linda S.	Moultonboro, NH	CPA	Indefinite from March 4, 2004
Gilpin, Charles H.	San Leandro, CA	Enrolled Agent	Indefinite from March 5, 2004
Smith, Sean M.	Silver Spring, MD	Enrolled Agent	Indefinite from March 15, 2004
Morelini, Wayne C.	Modesto, CA	Enrolled Agent	Indefinite from March 15, 2004
Bower, Jay	Redmond, OR	Enrolled Agent	Indefinite from March 16, 2004
Lynn, Celia M.	Locust Grove, VA	Enrolled Agent	Indefinite from April 1, 2004
Swantz Jr., H. E.	San Diego, CA	Enrolled Agent	Indefinite from April 6, 2004
Hart, David A.	Lake Zurich, IL	Enrolled Agent	Indefinite from April 8, 2004
Lau, Dennis K.M.	Honolulu, HI	Enrolled Agent	Indefinite from April 20, 2004
Lentz, Carole	Mastic, NY	Enrolled Agent	Indefinite from April 23, 2004
Goble, Dennis R.	Valparaiso, IN	CPA	Indefinite from April 26, 2004
Rivera, Eduardo M.	Torrence, CA	Attorney	May 1, 2004 to October 29, 2006

Name	Address	Designation	Date of Suspension
Grant, Elaine C.	Woodway, WA	Enrolled Agent	May 1, 2004 to October 31, 2004
Bell, Don	Grand Junction, CO	Enrolled Agent	Indefinite from May 1, 2004
Cohick, Jeffrey S.	Newville, PA	Enrolled Agent	May 1, 2004 from October 30, 2004

## Expedited Suspensions From Practice Before the Internal Revenue Service

Under Title 31, Code of Federal Regulations, Part 10, the Director, Office of Professional Responsibility, 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 certain crimes.

The following individuals have been placed under suspension from practice before the Internal Revenue Service by virtue of the expedited proceeding provisions:

Name	Address	Designation	Date of Suspension
Candelario, Alexander	Cabins, WV	CPA	Indefinite from February 1, 2004
Riener, Richard	St. Paul, MN	Attorney	Indefinite from March 1, 2004
Dunkle, Clark	Carlisle, PA	CPA	Indefinite from March 15, 2004
Bailey, Donald D.	Tucson, AZ	CPA	Indefinite from March 18, 2004
Hill, Donald R.	Clinchco, VA	CPA	Indefinite from April 1, 2004
Bergeson, Nancy	Inver Grove Hghts, MN	CPA	Indefinite from April 14, 2004
Reese, Kenneth J.	Nebraska City, NE	CPA	Indefinite from April 15, 2004
Coates, Marsden S.	Baltimore, MD	Attorney	Indefinite from April 15, 2004

Name	Address	Designation	Date of Suspension
Schaefer, Robert J.	Moorhead, MN	Attorney	Indefinite from April 20, 2004
Mills, Stuart B.	Pender, NE	Attorney	Indefinite from May 1, 2004
Harris-Smith, Bridgette	Silver Spring, MD	Attorney	Indefinite from May 3, 2004
Janousek, Donald R.	Omaha, NE	Attorney	Indefinite from May 3, 2004
Williams, Gary W.	Diamond Bar, CA	CPA	Indefinite from May 3, 2004
Demaio, Louis J.	Bel Air, MD	Attorney	Indefinite from May 3, 2004
Miller, Frederick C.	Cedar Hill, TX	CPA	Indefinite from May 15, 2004

## Censure Issued by Consent

Under Title 31, Code of Federal Regulations, Part 10, in lieu of a proceeding being instituted or continued, an attorney, certified public accountant, enrolled agent,

or enrolled actuary, may offer his or her consent to the issuance of a censure. Censure is a public reprimand.

The following individuals have consented to the issuance of a Censure:

Name	Address	Designation	Date of Censure
Friedman, Milton G.	Ft. Lauderdale, FL	CPA	December 30, 2003
Stevens, William E.	Omaha, NE	CPA	February 13, 2004
Turner, Mark A.	Cincinnati, OH	CPA	February 25, 2004
Rath, Dorris A.	Bradenton, FL	Enrolled Agent	March 9, 2004
Damiano, Lisa	South Windsor, CT	Enrolled Agent	March 9, 2004
Silbiger, Arnold R.	Baltimore, MD	Attorney	March 11, 2004
Farwell, Nancy K.	Citrus Heights, CA	Enrolled Agent	April 5, 2004
Dembrowski, Karen E.	Encino, CA	CPA	April 13, 2004

## **Correction to Announcement 2004-43**

### **Announcement 2004-51**

This is to correct an error in the second sentence of section V. of Announcement 2004-43, 2004-21 I.R.B. 955. The phrase “that begins during calendar 2004” should read “that begins before April 1, 2004.”

As a result, section V. is corrected to read as follows:

Notwithstanding the requirement to make an election by the end of the first quarter of the plan year, the following transitional rules are applicable. If an employer makes an alternative deficit reduction contribution election on or before June 30, 2004, that election will be deemed timely for the plan year

that begins before April 1, 2004. In addition, if an employer issues a PBGC notice for a plan on or before June 5, 2004, the PBGC will treat the PBGC notice as timely issued.



# 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 laws 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 a 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 Contributions 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. Rul.—Revenue Ruling.  
S—Subsidiary.  
S.P.R.—Statement of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

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<sup>1</sup> A cumulative list of current actions on previously published items in Internal Revenue Bulletins 2003–27 through 2003–52 is in Internal Revenue Bulletin 2003–52, dated December 29, 2003.

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