

## 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. 98-19, page 5.

Relocation payments; Housing and Community Development Act. A relocation payment, authorized by section 105(a)(11) of the Housing and Community Development Act and funded under the 1997 Emergency Supplemental Appropriations Act for Recovery From Natural Disasters, made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is not includible in the individual's gross income.

Rev. Rul. 98-20, page 8.

LIFO; price indexes; department stores. The February 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, February 28, 1998.

T.D. 8763, page 5.

Final regulations under section 166 of the Code deem a charge-off and allow a deduction for a partially worthless debt when the terms of a debt instrument have been modified.

T.D. 8764, page 9.

REG-102144-98, page 25.

Temporary and proposed regulations under sections 925 and 927 of the Code provide guidance to taxpayers who have made an election to be treated as a foreign sales corporation (FSC). A public hearing on the proposed regulations will be held on June 24, 1998.

### EXEMPT ORGANIZATIONS

Announcement 98-28, page 30.

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

### ADMINISTRATIVE

REG-209322-82, page 26.

Proposed regulations under sections 6031 and 6063 of the Code revise the partnership filing requirement to reflect changes to the law made by the Taxpayer Relief Act of 1997 (TRA). LR-198-82, 1986-1 C.B. 778 is withdrawn. A public hearing will be held on May 19, 1998.

Rev. Proc. 98-27, page 15.

This procedure provides guidance to foreign financial institutions that desire to enter into a withholding agreement with the Service in order to be treated as qualified intermediaries under new section 1.1441-1(e)(5) of the Income Tax Regulations. It describes the application procedures for becoming a qualified intermediary and the terms that the Service will ordinarily require in a withholding agreement.

Rev. Proc. 98-28, page 14.

Qualified mortgage bonds; mortgage credit certificates; national median gross income. Guidance is provided concerning the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. Rev. Proc. 97-26 is obsolete except as provided in section 5.02 of this revenue procedure.

Continued on page 4

Finding Lists begin on page 35.



# Mission of the Service

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

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

## Statement of Principles of Internal Revenue Tax Administration

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

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

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

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

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

# Introduction

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

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

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

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

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

The Bulletin is divided into four parts as follows:

**Part I.—1986 Code.**

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

**Part II.—Treaties and Tax Legislation.**

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

**Part III.—Administrative, Procedural, and Miscellaneous.**

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

**Part IV.—Items of General Interest.**

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

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

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## HIGHLIGHTS OF THIS ISSUE—Continued

### ADMINISTRATIVE—Continued

Rev. Proc. 98-29, page 22.

Inventory shrinkage estimates. Guidance, including a “retail safe harbor method,” is provided for a taxpayer that wants to change to a method of accounting for estimating inventory “shrinkage” in computing ending inventory.

Notice 98-16, page 12.

This notice announces that the Service will amend the effective date of the section 1441 withholding regulations to apply to payments made after December 31, 1999.

Notice 98-21, page 14.

Extension of the effective date of the Classification Settlement Program. The Service is extending the Classification Settlement Program or “CSP” until further notice.

Announcement 98-27, page 30.

The Service announces that Forms W-9 and W-9S can be filed electronically.

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

## Section 25.—Interest on Certain Home Mortgages

*26 CFR 1.25-4T: Qualified mortgage credit certificate program (temporary).*

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 98-28, page 14.

## Section 61.—Gross Income Defined

*26 CFR 1.61-1: Gross income.*

**Relocation payments; Housing and Community Development Act.** A relocation payment, authorized by section 105(a)(11) of the Housing and Community Development Act and funded under the 1997 Emergency Supplemental Appropriations Act for Recovery From Natural Disasters, made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is not includible in the individual's gross income.

Rev. Rul. 98-19

### ISSUE

Is a relocation payment authorized pursuant to section 105(a)(11) of Title I of the Housing and Community Development Act of 1974 (Act), 42 U.S.C. § 5305(a)(11), funded under the 1997 Emergency Supplemental Appropriations Act for Recovery From Natural Disasters (Supplemental Act), Pub. L. No. 105-18, 111 Stat. 158, 198-199, and made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, includible in the individual's gross income under § 61 of the Internal Revenue Code?

### FACTS

Pursuant to the Act and the Supplemental Act, a resident of a local jurisdiction, within a Presidentially-declared disaster area in the upper Midwest, received a relocation payment from the local jurisdiction to help defray the expenses of mov-

ing from the resident's flood-damaged residence to another residence.

According to section 101(c) of the Act, the primary objective of Title I "is the development of viable urban communities, by providing decent housing and a suitable living environment and expanding economic opportunities, principally for persons of low and moderate income." 42 U.S.C. § 5301(c). Section 105(a)(11) of the Act provides, in part, that a community development program may provide relocation payments and assistance for displaced individuals and families as authorized under the Act. 42 U.S.C. § 5305(a)(11).

The Supplemental Act provides funding, for displaced individuals and families as authorized under the Act, to certain communities affected by the flooding in the upper Midwest and other Presidentially-declared disasters occurring during the federal government's fiscal year ending September 30, 1997.

### LAW AND ANALYSIS

Section 61 and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

The Service has held that payments made under legislatively provided social benefit programs for the promotion of general welfare are not includible in a recipient's gross income. See Rev. Rul. 76-373, 1976-2 C.B. 16, which holds that relocation payments received by individuals pursuant to section 105(a)(11) of the Act are in the nature of general welfare and are not includible in the gross incomes of recipients.

### HOLDING

A relocation payment authorized pursuant to section 105(a)(11) of the Act, funded under the Supplemental Act, and made by a local jurisdiction to an individual moving from a flood-damaged residence to another residence, is in the nature of general welfare and is not includible in the individual's gross income under § 61.

### DRAFTING INFORMATION

The principal author of this revenue ruling is Sheldon A. Iskow of the Office

of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Iskow on (202) 622-4920 (not a toll-free call).

## Section 103.—State and Local Bonds

*26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.*

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 98-28, page 14.

## Section 143.—Mortgage Revenue Bonds: Qualified Mortgage Bond and Qualified Veterans' Mortgage Bond

*26 CFR 6a.103A-2: Qualified mortgage bond.*

Guidance is provided for the use of the national and area median gross income figures by issuers of qualified mortgage bonds and mortgage credit certificates in determining the housing cost/income ratio described in section 143(f)(5) of the Code. See Rev. Proc. 98-28, page 14.

## Section 166.—Bad Debts

*26 CFR 1.166-3: Partial or total worthlessness.*

T.D. 8763

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 1

## Modifications of Bad Debts and Dealer Assignments of Notional Principal Contracts

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Final and temporary regulations.

SUMMARY: This document contains regulations that deem a charge-off and allow a deduction for a partially worthless debt when the terms of a debt instrument

have been modified. The regulations provide guidance to certain taxpayers that have claimed a deduction for a partially worthless debt and then modified the terms of the debt instrument. This document also contains regulations relating to certain assignments of notional principal contracts by dealers in those contracts. The regulations provide guidance to taxpayers relating to the consequences of these assignments.

**DATES:** *Effective date:* These regulations are effective January 29, 1998.

*Applicability date:* These regulations apply to significant modifications of debt instruments and assignments of interest rate swaps, commodity swaps, and other notional principal contracts occurring on or after September 23, 1996.

**FOR FURTHER INFORMATION CONTACT:** Concerning the modifications of bad debts, Craig Wojay, (202) 622-3920, and concerning dealer assignments of notional principal contracts, Thomas M. Preston, (202) 622-3940 (not toll-free numbers).

**SUPPLEMENTARY INFORMATION:**

*Background*

On June 25, 1996, temporary regulations (T.D. 8676 [1996-2 C.B. 9]) relating to modifications of bad debts and dealer assignments of notional principal contracts under sections 166 and 1001 of the Internal Revenue Code (Code) were published in the **Federal Register** (61 F.R. 32653). A notice of proposed rulemaking (REG-209743-94, formerly FI-59-94 [1996-2 C.B. 442]) cross-referencing the temporary regulations was published in the **Federal Register** for the same day (61 F.R. 32728). No public hearing was requested or held.

Written comments responding to the notice were received. After consideration of the comments, the regulations proposed by REG-209743-94 are adopted by this Treasury decision, and the corresponding temporary regulations are removed.

*Explanation of Provisions*

The preamble to the temporary regulations sets forth limited circumstances under which a taxpayer will be permitted

to deduct an amount on account of a partially worthless debt even though an amount has not been charged off within the taxable year.

Section 166(a)(2) and §1.166-3(a) provide that a deduction for a partially worthless debt is allowed only to the extent the debt is charged off in the taxable year. The charge-off requirement is satisfied when a portion of the debt is removed from the taxpayer's books and records. This generally is accomplished by reducing the debt's book basis. Thus, when an amount has been deducted for partial worthlessness, there is generally a reduction of both the book basis and the tax basis of a debt.

When a taxpayer is required to recognize gain under §1.1001-1 because of a modification of a debt instrument, the taxpayer's tax basis in the debt is increased by the amount of gain recognized. However, regulatory and general accounting principles generally would not permit a corresponding increase in the book basis of the debt. Because the prior charge-off is not restored (that is, the book basis of the debt is not increased), there is no opportunity for the taxpayer to take a new charge-off for pre-existing worthlessness.

The purpose of the temporary regulations is to preserve a portion of a taxpayer's bad debt deduction with respect to a partially worthless debt. The portion preserved corresponds to the amount the taxpayer would have been entitled to deduct for partial worthlessness with respect to the modified debt if the book basis of the modified debt were increased to the same extent as the tax basis of that debt. Thus, if all the conditions of the temporary regulations are satisfied, then a modified debt is deemed to have been charged off in the year in which gain is recognized. The amount of the deemed charge-off, however, is limited to the difference between the tax basis of the debt and the greater of the book basis or the fair market value of the debt. The temporary regulations also address debt that constitutes transferred basis property under section 7701(a)(43).

In addition, the temporary regulations provide a limited rule dealing with a dealer's assignment of its position in an interest rate swap, commodity swap, or other notional principal contract to another dealer. If the assignment is permit-

ted by the terms of the contract, the assignment is not treated as a deemed exchange by the nonassigning party of the original contract for a new contract that differs materially either in kind or in extent. Thus, an assignment to which the rule applies does not trigger gain or loss to the dealer's counterparty.

Three comments were received on the §1.166-3T regulations. The first comment requests a deemed charge-off for a taxpayer that purchased at a discount debt for which a previous deduction for partial worthlessness was claimed, and then significantly modified the debt under §1.1001-3 and recognized gain on the modification. Whenever debt is purchased for less than the stated redemption price, recognized gain from a significant modification is attributable to market discount as defined in section 1278(a)(2)(A) and not to a previously claimed deduction for partial worthlessness. In addition, the temporary regulations refer to §1.166-3(a)(1) and (2) for guidance relating to prior charge-offs and deductions for partial worthlessness. Extending the temporary regulations to cover a discount purchase would significantly expand the regulations beyond their intended scope and create a situation that would be extremely difficult to administer. The regulations do not adopt the request to extend the regulations to cover such a purchase.

The second comment requests a deemed charge-off for a member of a consolidated group that purchased debt, for which a previous deduction for partial worthlessness was claimed, from another member of the group, then significantly modified the debt under §1.1001-3 and recognized gain on the modification. Whenever debt is purchased for less than the stated redemption price, subsequently recognized gain from a significant modification is attributable to market discount as defined in section 1278(a)(2)(A) and not to a previously claimed deduction for partial worthlessness. Extending the temporary regulations to cover a purchase from another member of the consolidated group would significantly expand the regulations beyond their intended scope. The regulations do not adopt the request to extend the regulations to cover an intercompany transaction.

The third comment requests expanding the temporary regulations to include other

situations in which a taxpayer has tax basis in a debt but no corresponding book basis. The first situation involves the accrual of interest income on loans that have been placed on non-accrual status for book purposes. The second situation involves the requirement to accrue interest on original issue discount obligations even if the loan has become uncollectible. This comment deals with situations other than the modification of a debt instrument and is beyond the scope of this regulation project.

*Special Analyses*

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

*Drafting Information*

The principal author of the regulations concerning the modifications of bad debts is Craig Wojay, Office of the Assistant Chief Counsel (Financial Institutions and Products), IRS. The principal author of the regulations concerning the dealer assignments of notional principal contracts is Thomas M. Preston, Office of the Assistant Chief Counsel (Financial Institutions and Products), 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. In §1.166–3, paragraph (a)(3) is added to read as follows:

*§1.166–3 Partial or total worthlessness.*

(a) \* \* \*

(3) *Significantly modified debt—(i) Deemed charge-off.* If a significant modification of a debt instrument (within the meaning of §1.1001–3) during a taxable year results in the recognition of gain by a taxpayer under §1.1001–1(a), and if the requirements of paragraph (a)(3)(ii) of this section are met, there is a deemed charge-off of the debt during that taxable year in the amount specified in paragraph (a)(3)(iii) of this section.

(ii) *Requirements for deemed charge-off.* A debt is deemed to have been charged off only if—

(A) The taxpayer (or, in the case of a debt that constitutes transferred basis property within the meaning of section 7701(a)(43), a transferor taxpayer) has claimed a deduction for partial worthlessness of the debt in any prior taxable year; and

(B) Each prior charge-off and deduction for partial worthlessness satisfied the requirements of paragraphs (a)(1) and (2) of this section.

(iii) *Amount of deemed charge-off.* The amount of the deemed charge-off, if any, is the amount by which the tax basis of the debt exceeds the greater of the fair market value of the debt or the amount of the debt recorded on the taxpayer’s books and records reduced as appropriate for a specific allowance for loan losses. The amount of the deemed charge-off, however, may not exceed the amount of recognized gain described in paragraph (a)(3)(i) of this section.

(iv) *Effective date.* This paragraph (a)(3) applies to significant modifications of debt instruments occurring on or after September 23, 1996.

\* \* \* \* \*

**§1.166–3T [Removed]**

Par. 3. Section 1.166–3T is removed.

Par. 4. Section 1.1001–4 is added to read as follows:

*§1.1001–4 Modifications of certain notional principal contracts.*

(a) *Dealer assignments.* For purposes of §1.1001–1(a), the substitution of a new

party on an interest rate or commodity swap, or other notional principal contract (as defined in §1.446–3(c)(1)), is not treated as a deemed exchange by the nonassigning party of the original contract for a modified contract that differs materially either in kind or in extent if—

(1) The party assigning its rights and obligations under the contract and the party to which the rights and obligations are assigned are both dealers in notional principal contracts, as defined in §1.446–3(c)(4)(iii); and

(2) The terms of the contract permit the substitution.

(b) *Effective date.* This section applies to assignments of interest rate swaps, commodity swaps, and other notional principal contracts occurring on or after September 23, 1996.

**§1.1001–4T [Removed]**

Par. 5. Section 1.1001–4T is removed.

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

Approved January 14, 1998.

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

(Filed by the Office of the Federal Register on January 28, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 29, 1998, 63 F.R. 4396)

**Section 471.—General Rule for Inventories**

*26 CFR 1.471–2: Valuation of inventories.*

Guidance, including a “retail safe harbor method,” is provided for a taxpayer that wants to change to a method of accounting for estimating inventory “shrinkage” in computing ending inventory. See Rev. Proc. 98–29, page 22.

**Section 472.—Last-in, First-out Inventories**

*26 CFR 1.472–1: Last-in, first-out inventories.*

**LIFO; price indexes; department stores.** The February 1998 Bureau of Labor Statistics price indexes are accepted for use by department stores em-

ploying the retail inventory and last-in, first-out inventory methods for valuing inventories for tax years ended on, or with reference to, February 28, 1998.

Rev. Rul. 98-20

The following Department Store Inventory Price Indexes for February 1998 were issued by the Bureau of Labor Sta-

tistics. The indexes are accepted by the Internal Revenue Service, under § 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 86-46, 1986-2 C.B. 739, for appropriate application to inventories of department stores employing the retail inventory and last-in, first-out inventory methods for tax years ended on, or with reference to, February 28, 1998.

The Department Store Inventory Price

Indexes are prepared on a national basis and include (a) 23 major groups of departments, (b) three special combinations of the major groups - soft goods, durable goods, and miscellaneous goods, and (c) a store total, which covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE  
INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS  
(January 1941 = 100, unless otherwise noted)

Groups	Feb. 1997	Feb. 1998	Percent Change from Feb. 1997 to Feb. 1998 <sup>1</sup>
1. Piece Goods . . . . .	526.4	535.8	1.8
2. Domestic and Draperies . . . . .	650.4	639.3	-1.7
3. Women's and Children's Shoes . . . . .	640.2	656.9	2.6
4. Men's Shoes . . . . .	897.7	886.5	-1.2
5. Infants' Wear . . . . .	617.7	612.6	-0.8
6. Women's Underwear . . . . .	534.2	565.2	5.8
7. Women's Hosiery . . . . .	296.5	308.1	3.9
8. Women's and Girls' Accessories . . . . .	546.9	548.2	0.2
9. Women's Outerwear and Girls' Wear . . . . .	417.6	408.9	-2.1
10. Men's Clothing . . . . .	615.4	624.0	1.4
11. Men's Furnishings . . . . .	585.1	590.4	0.9
12. Boys' Clothing and Furnishings . . . . .	469.9	499.3	6.3
13. Jewelry . . . . .	1004.9	1001.0	-0.4
14. Notions . . . . .	772.0	802.0	3.9
15. Toilet Articles and Drugs . . . . .	912.3	926.5	1.6
16. Furniture and Bedding . . . . .	662.0	668.3	1.0
17. Floor Coverings . . . . .	581.2	583.7	0.4
18. Housewares . . . . .	817.0	810.3	-0.8
19. Major Appliances . . . . .	246.1	242.0	-1.7
20. Radio and Television . . . . .	78.6	73.6	-6.4
21. Recreation and Education <sup>2</sup> . . . . .	111.1	107.7	-3.1
22. Home Improvements <sup>2</sup> . . . . .	133.3	134.0	0.5
23. Auto Accessories <sup>2</sup> . . . . .	107.9	107.7	-0.2
Groups 1 - 15: Soft Goods . . . . .	598.9	601.1	0.4
Groups 16 - 20: Durable Goods . . . . .	470.0	462.4	-1.6
Groups 21 - 23: Misc. Goods <sup>2</sup> . . . . .	113.3	111.0	-2.0
Store Total <sup>3</sup> . . . . .	554.2	552.3	-0.3

<sup>1</sup>Absence of a minus sign before percentage change in this column signifies price increase.

<sup>2</sup>Indexes on a January 1986=100 base.

<sup>3</sup>The store total index covers all departments, including some not listed separately, except for the following: candy, food, liquor, tobacco, and contract departments.



## DRAFTING INFORMATION

The principal author of this revenue ruling is Stan Michaels of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue ruling, contact Mr. Michaels on (202) 622-4970 (not a toll-free call).

## Section 925.—Transfer Pricing Rules

26 CFR 1.925(a)–1T: Temporary regulations; transfer pricing rules for FSCs.

T.D. 8764

DEPARTMENT OF THE TREASURY  
Internal Revenue Service  
26 CFR Part 1

### Source and Grouping Rules for Foreign Sales Corporation Transfer Pricing

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations that provide guidance to taxpayers who have made an election to be treated as a foreign sales corporation (FSC). The regulations provide rules that clarify the special sourcing rules under section 927(e)(1) and provide a deadline for the election to group transactions. The text of the temporary regulations also serves as the text of the proposed regulations on this subject in REG-102144-98, page 25 of this Bulletin.

DATES: *Effective date:* These regulations are effective March 3, 1998.

*Applicability:* For dates of applicability, see §§1.925(a)–1T(c)(8)(i) and 1.927(e)–1T(c).

FOR FURTHER INFORMATION CONTACT: Elizabeth Beck (202) 622-3880 (not a toll-free number).

### SUPPLEMENTARY INFORMATION:

#### *Background*

This document contains amendments to the Income Tax Regulations (26 CFR part 1) under sections 925 and 927 which were

added by the Deficit Reduction Act of 1984, applicable for taxable years of foreign sales corporations beginning after December 31, 1984. Temporary regulations were published in the **Federal Register** (52 F.R. 6468) as a Treasury Decision (T.D. 8126 [1987–1 C.B. 184]) on March 3, 1987. Treasury and IRS believe that immediate guidance in the form of these temporary regulations is necessary for the reasons stated below.

#### *Explanation of Provisions*

These regulations set a deadline for an election to group transactions for purposes of the foreign sales corporation (FSC) administrative pricing methods and clarify that the foreign source limit for a FSC's related supplier extends to all transactions giving rise to foreign trading gross receipts.

#### I. *Grouping Election Deadline.*

##### A. *Current temporary regulations.*

Current §1.925(a)–1T(c)(8) and §1.925(b)–1T(b)(3) permit taxpayers annually to group transactions in applying the administrative pricing (including the marginal costing) rules to determine FSC benefits. Current §1.925(a)–1T(c)(8)(i) requires an election to group to be evidenced on the FSC income tax return for the taxable year. Current §1.925(a)–1T(e)(4) authorizes taxpayers to file amended returns subsequently (within the statute of limitations period) to redetermine FSC benefits based on a different grouping of transactions than that originally elected. Pursuant to this provision, taxpayers may change their grouping basis, or change from a grouping to a transaction-by-transaction basis. The IRS and the Treasury have become increasingly aware of taxpayers who, through the use of sophisticated computer programs, substantially revise their transaction groupings just prior to the expiration of the statute of limitations and many years after the original returns were filed. These revised groupings typically employ complex estimating techniques. The recent rise in this practice is placing a significant burden on the auditing process and is creating a potential for abuse.

##### B. *Revised temporary regulations.*

Under §1.925(a)–1T(c)(8)(i), the election to group must be made on Schedule P

of the FSC's timely filed U.S. income tax return (including extensions thereof) for the taxable year. No untimely or amended returns will be allowed to elect to group, to change a grouping basis, or to change from a grouping basis to a transaction-by-transaction basis for such year.

Conforming changes and cross-references are reflected in §1.925(a)–1T(e)(4) and §1.925(b)–1T(b)(3).

The regulations apply to taxable years beginning after December 31, 1997. There is also a transition rule providing that the regulations also apply to taxable years beginning before January 1, 1998. For these taxable years, the transition rule allows taxpayers to redetermine their grouping of transactions with respect to such years provided such redetermination is made no later than the due date of the FSC's timely filed U.S. income tax return (including extensions thereof) for its first taxable year beginning after December 31, 1997.

#### II. *Scope of Related Supplier Foreign Source Limit.*

##### A. *Current temporary regulations and TRA 97.*

Section 927(e)(1) provides that “[u]nder regulations, the income of a person described in section 482 from a transaction giving rise to foreign trading gross receipts of a FSC which is treated as from sources outside the United States shall not exceed the amount which would be treated as foreign source income earned by such person if the pricing rule under section 994 which corresponds to the rule used under section 925 with respect to such transaction applied to such transaction.” Transactions giving rise to foreign trading gross receipts include qualifying sales, leases, licenses and services. Current §1.927(e)–1T restates the section 927(e)(1) rule as applicable on “the sale of export property.” While the statute is not limited to export sale transactions in that it applies to any transaction giving rise to foreign trading gross receipts of a FSC, the current regulation might be interpreted to apply the special foreign sourcing limit only to sales of export property.

Section 1171 of the Taxpayer Relief Act of 1997 (TRA 97) amended section 927(a)(2)(B) (without any inference intended regarding prior law) to provide

that computer software licensed for reproduction abroad is included within the definition of export property for purposes of the FSC provisions. The amendment applies to gross receipts from computer software licenses attributable to periods after December 31, 1997, in tax years ending after such date.

In light of TRA 97, it is important to clarify the scope of the related supplier's foreign source limit under the regulations. This clarification needs to be implemented immediately in order to provide clear guidance to taxpayers, including those utilizing the TRA 97 amendment to section 927(a)(2)(B).

**B. Revised temporary regulations.**

Under §1.927(e)-1T(a)(1), the related supplier's foreign source limit applies to any transaction, including but not limited to any sale, lease, license or service, giving rise to foreign trading gross receipts of a FSC. No inference is intended regarding the scope of application of the prior regulation.

Conforming changes are reflected in §1.927(e)-1T(a)(2) and (3). Special rules are added in §1.927(e)-1T(a)(3)(ii) to clarify how the corresponding DISC transfer pricing rules are to be applied for purposes of the foreign source limit. Three examples set forth in §1.927(e)-1T(b) illustrate how the limit is applied under different transfer pricing methods and for different types of transactions.

The regulations apply to taxable years beginning after December 31, 1997.

*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 has also been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these regulations, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, these temporary regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

*Drafting Information*

The principal author of these regulations is Elizabeth Beck of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

\* \* \* \* \*

*Adoption of Amendments to the Regulations*

Accordingly, 26 CFR part 1 is amended as follows:

**PART 1—INCOME TAXES**

Paragraph 1. The authority citation for part 1 is amended by revising the entries for sections 1.925(a)-1T and 1.925(b)-1T to read as follows:

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

Section 1.925(a)-1T is also issued under 26 U.S.C. 925(b)(1) and (2) and 927(d)(2)(B).

Section 1.925(b)-1T is also issued under 26 U.S.C. 925(b)(1) and (2) and 927(d)(2)(B) \* \* \*

Par. 2. Section 1.925(a)-1T is amended by:

1. Removing the last sentence of paragraph (c)(8)(i) and adding five sentences in its place.

2. Paragraph (e)(4) is amended by:

a. Removing the language "or grouping of transactions" from the fourth sentence.

b. Adding a sentence to the end of the paragraph.

The additions read as follows:

*§1.925(a)-1T Temporary Regulations; Transfer pricing rules for FSCs.*

\* \* \* \* \*

(c) \* \* \*

(8) \* \* \* (i) \* \* \* The election to group transactions shall be evidenced on Schedule P of the FSC's timely filed U.S. income tax return (including extensions thereof) for the taxable year. No untimely or amended returns will be allowed to elect to group, to change a grouping basis, or to change from a grouping basis to a transaction-by-transaction basis. The rules of the previous two sentences of this paragraph (c)(8)(i) are applicable to taxable years beginning after December 31,

1997. For any taxable year beginning before January 1, 1998, for which a redetermination is otherwise permissible under paragraph (e)(4) of this section as in effect for taxable years beginning before January 1, 1998, a redetermination of grouping of transactions cannot be made later than the due date of the FSC's timely filed U.S. income tax return (including extensions thereof) for the FSC's first taxable year beginning after December 31, 1997. The language "or grouping of transactions" is removed from the fourth sentence of paragraph (e)(4) of this section, applicable to taxable years beginning after December 31, 1997.

\* \* \* \* \*

(e) \* \* \*

(4) \* \* \* For the election to group transactions for purposes of applying the administrative pricing methods, see paragraph (c)(8)(i) of this section.

\* \* \* \* \*

Par. 3. In §1.925(b)-1T, paragraph (b)(3)(i) is amended by adding at the end of the paragraph the following sentence:

*§1.925(b)-1T Temporary regulations; marginal costing rules.*

\* \* \* \* \*

(b) \* \* \*

(3) \* \* \* (i) \* \* \* For the election to group transactions for purposes of applying the administrative pricing methods, see §1.925(a)-1T(c)(8)(i).

\* \* \* \* \*

Par. 4. Section 1.927(e)-1T is revised to read as follows:

*§1.927(e)-1T Temporary regulations; special sourcing rule.*

(a) *Source rules for related persons—*  
 (1) *In general.* The income of a person described in section 482 from a transaction giving rise to foreign trading gross receipts of a FSC which is treated as from sources outside the United States shall not exceed the amount which would be treated as foreign source income earned by such person if the pricing rule under section 994 which corresponds to the rule used under section 925 with respect to such transaction applied to such transac-

tion. This section applies to any transaction, including but not limited to any sale, lease, license or service, giving rise to foreign trading gross receipts of a FSC. This special sourcing rule also applies if the FSC is acting as a commission agent for the related supplier with respect to the transaction described above which gives rise to foreign trading gross receipts and the transfer pricing rules of section 925 are used to determine the commission payable to the FSC. No limitation results under this section with respect to a transaction to which the section 482 pricing rule under section 925(a)(3) applies.

(2) *Grouping of transactions.* If, for purposes of determining the FSC's profits under the administrative pricing rules of sections 925(a)(1) and (2), grouping of transactions under §1.925(a)-1T(c)(8) was elected, the same grouping shall be used for making the determinations under this special sourcing rule.

(3) *Corresponding DISC pricing rules—(i) In general.* For purposes of this section—

(A) The DISC gross receipts pricing rule of section 994(a)(1) corresponds to the gross receipts pricing rule of section 925(a)(1);

(B) The DISC combined taxable income pricing rule of section 994(a)(2) corresponds to the combined taxable income pricing rule of section 925(a)(2); and

(C) The DISC section 482 pricing rule of section 994(a)(3) corresponds to the section 482 pricing rule of section 925(a)(3).

(ii) *Special rules.* For purposes of this section—

(A) The DISC pricing rules of section 994(a)(1) and (2) shall be determined without regard to export promotion expenses;

(B) Qualified export receipts under section 994(a)(1) and (2) shall be deemed to be an amount equal to the foreign trading gross receipts arising from the transaction; and

(C) Combined taxable income for purposes of section 994(a)(2) shall be deemed to be an amount equal to the combined taxable income for purposes of section 925(a)(2) arising from the transaction.

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

*Example 1.* (i) R and F are calendar year taxpayers. R, a domestic manufacturing company, owns all the stock of F, which is a FSC acting as a commission agent for R. For the taxable year, R and F used the combined taxable income pricing rule of section 925(a)(2). For the taxable year, the combined taxable income of R and F is \$100 from the sale of export property, as defined in section 927(a), manufactured by R using production assets located in the United States. Title to the export property passed outside of the United States.

(ii) Under section 925(a)(2), 23 percent of the \$100 combined taxable income of R and F, that is \$23, is allocated to F and the remaining \$77 is allocated to R. Absent the special sourcing rule, under section 863(b) the \$77 income allocated to R would be sourced \$38.50 U.S. source and \$38.50 foreign source. Under the special sourcing rule, the amount of foreign source income earned by a related supplier of a FSC shall not exceed the amount that would result if the corresponding DISC pricing rule applied. The DISC combined taxable income pricing rule of section 994(a)(2) corresponds to the combined taxable income pricing rule of section 925(a)(2). Under section 994(a)(2), \$50 of the combined taxable income (\$100 x .50) would be allocated to the DISC and the remaining \$50 would be allocated to the related supplier. Under section 863(b), the \$50 income allocated to the DISC's related supplier would be sourced \$25 U.S. source and \$25 foreign source. Accordingly, under the special sourcing rule, the foreign source income of R shall not exceed \$25.

*Example 2.* (i) Assume the same facts as in *Example 1* except that the combined taxable income arises from the licensing of the copyright rights in computer software for use outside of the United States and that R developed the computer software in the United States.

(ii) Under section 925(a)(2), 23 percent of the \$100 combined taxable income of R and F, that is \$23, is allocated to F and the remaining \$77 is allocated to R. Absent the special sourcing rule, under section 862(a)(4) the \$77 income allocated to R would be sourced \$77 foreign source in its entirety. Under the special sourcing rule, the amount of foreign source income earned by a related supplier of a FSC shall not exceed the amount that would result if the corresponding DISC pricing rule applied. The DISC combined taxable income pricing rule of section 994(a)(2) corresponds to the combined taxable income pricing rule of section 925(a)(2). Under section 994(a)(2), \$50 of the combined taxable income (\$100 x .50) would be allocated to the DISC and the remaining \$50 would be allocated to the related supplier. Under section 862(a)(4), the \$50 income allocated to the DISC's related supplier would be sourced \$50 foreign source in its entirety. Accordingly, under the special sourcing rule, the foreign source income of R shall not exceed \$50.

*Example 3.* (i) Assume the same facts as in *Example 1* except that R and F used the gross receipts

pricing rule of section 925(a)(1). In addition, for the taxable year foreign trading gross receipts derived from the sale of the export property are \$2,000.

(ii) Under section 925(a)(1), 1.83 percent of the \$2,000 foreign trading gross receipts, that is \$36.60, is allocated to F and the \$63.40 remaining combined taxable income (\$100 - \$36.60) is allocated to R. Absent the special sourcing rule, under section 863(b) the \$63.40 income allocated to R would be sourced \$31.70 U.S. source and \$31.70 foreign source. Under the special sourcing rule, the amount of foreign source income earned by a related supplier of a FSC shall not exceed the amount that would result if the corresponding DISC pricing rule applied. The DISC gross receipts pricing rule of section 994(a)(1) corresponds to the gross receipts pricing rule of section 925(a)(1). Under section 994(a)(1), \$80 (\$2,000 x .04) would be allocated to the DISC and the \$20 remaining combined taxable income would be allocated to the related supplier. Under section 863(b), the \$20 income allocated to the DISC's related supplier would be sourced \$10 U.S. source and \$10 foreign source. Accordingly, under the special sourcing rule, the foreign source income of R shall not exceed \$10.

(c) *Effective Date.* The rules of this section are applicable to taxable years beginning after December 31, 1997.

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

Approved February 20, 1998.

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

(Filed by the Office of the Federal Register on March 2, 1998, 8:45 a.m., and published in the issue of the Federal Register for March 3, 1998, 63 F.R. 10305)

## Section 1441.—Withholding of Tax

This notice announces that the Department of the Treasury and the Internal Revenue Service will amend the effective date of the section 1441 withholding regulations to apply to payments made after December 31, 1999. The transition rules provided under those regulations will also be amended to be consistent with the later effective date of those regulations. This Notice also amends the related transition rule of Notice 97-66, 1997-48 I.R.B. 8, to be consistent with the later effective date of the 1441 regulations. Finally, this Notice announces that the Internal Revenue Service intends to develop model withholding agreements for qualified intermediaries on a country by country basis. See Notice 98-16, page 12.

## Part III. Administrative, Procedural, and Miscellaneous

### Effective Date of Regulations Under Section 1441 and Qualified Intermediary Procedures

#### Notice 98-16

##### Section 1. Scope

This notice announces that the Department of the Treasury (“Treasury”) and the Internal Revenue Service (the “IRS”) will extend the effective date of the section 1441 withholding regulations. As extended, those regulations will apply to certain payments made to foreign persons after December 31, 1999. This notice also provides new transition rules for satisfying the withholding certificate or statement requirements under the withholding regulations. Finally, this notice describes the general procedure the IRS will follow in entering into qualified intermediary withholding agreements in order to expedite the process of making such agreements as widely available as possible.

##### Section 2. Background

On October 14, 1997, final Income Tax Regulations (the “final withholding regulations”) substantially revising and replacing existing regulations regarding the withholding of tax under chapter 3 (sections 1441-1464) of the Internal Revenue Code (the “Code”) were published in the Federal Register as T.D. 8734. Those regulations also significantly revise existing information reporting and backup withholding regulations under chapter 61 and section 3406 of the Code. As promulgated, the final withholding regulations will apply to all payments made after December 31, 1998.

##### Section 3. Extended Effective Date

Treasury and the IRS will amend the final withholding regulations to extend the date of applicability of those regulations to payments made after December 31, 1999. Treasury and the IRS recognize that the final withholding regulations contain substantial changes to existing rules and will likely require significant changes to business practices and information systems for many U.S. and foreign withhold-

ing agents. These changes come at a time when many of these entities are also attempting to make significant changes to business practices and information systems to conform to the Year 2000 date change and the European Monetary Union currency conversion.

Treasury and the IRS also must ensure that qualified intermediary withholding agreements are available to as many financial intermediaries as possible for the final withholding regulations to be effectively implemented. As described more fully below, Treasury and the IRS expect that the process for making qualified intermediary withholding agreements widely available will take several months from the date the process begins.

Accordingly, Treasury and the IRS believe it is in the best interest of tax administration to extend the date of applicability of the final withholding regulations to ensure that both taxpayers and the government can complete the changes necessary to implement the new withholding regime. As extended by this notice, the final withholding regulations will apply to payments made after December 31, 1999.

In addition, the IRS will regard the 1999 calendar year as a transition period for the administration of the withholding tax system. Accordingly, in enforcing compliance with current withholding rules for calendar year 1999, the IRS will take into account the extent to which a withholding agent makes a good faith effort during that period to transform its business practices and information systems to comply with the final withholding regulations. For example, the IRS will take into account whether a U.S. withholding agent makes reasonable efforts during 1999 to modify its account opening practices to conform to the new documentation requirements, obtain new documentation on existing accounts when new withholding certificates become available, and make appropriate systems changes to comply with the final withholding regulations and, if appropriate, Rev. Proc. 98-27 (relating to qualified intermediary withholding agreements). For foreign withholding agents, the IRS will also take into account whether or not the withholding agent makes an effort to seek qualified intermediary status. The IRS

will also take into account whether or not a withholding agent (whether U.S. or foreign) effectively implements the final withholding regulations beginning on January 1, 2000.

##### Section 4. Modified Transition Rules

The final withholding regulations provide transition rules for obtaining new withholding certificates and statements containing the necessary information and representations required by those regulations. The IRS released and requested public comments on draft new withholding certificates in Announcement 98-15, published in 1998-10 I.R.B. 36. The new withholding certificates would replace current Forms W-8, 1001, 4224, 8709, and 1078, and statements described in §1.1441-5 of the regulations in effect before January 1, 1999 (the “existing certificates or statements”).

Generally, under the transition rules contained in the final withholding regulations, a withholding agent holding a valid existing certificate or statement on December 31, 1998, may treat that certificate or statement as valid until the earlier of its expiration or December 31, 1999. In addition, the transition rules provide that any existing withholding certificate or statement that is valid on January 1, 1998, and that expires during 1998, remains valid until December 31, 1998. (These rules cannot operate together, however, to extend beyond December 31, 1998, the validity of a certificate that, without the transition rule, would expire in 1998.)

The IRS intends to modify the withholding certificate and statement transition rules of the final withholding regulations to provide that a withholding agent holding a valid existing certificate or statement on December 31, 1999, may treat that certificate or statement as valid until the earlier of its expiration or December 31, 2000. No existing certificates or statements will be effective after December 31, 2000. As under the final regulations, existing certificates and statements that expire in 1999 will not be effective after expiration. The existing transition rule providing that any existing withholding certificate or statement that is valid on January 1, 1998, and that expires during 1998 remains valid until Decem-

ber 31, 1998, will be retained. This rule should ensure that withholding agents will be able to replace existing withholding certificates or statements that expire in 1998 with new certificates that will be valid under the final withholding regulations when those regulations take effect. The IRS anticipates that new withholding certificates will be available before December 31, 1998.

New withholding certificates that are valid under the final withholding regulations will be deemed to satisfy the requirements under the regulations in effect before January 1, 2000, to obtain Forms W-8, 1001, 4224, 8709, or a statement under section 1.1441-5. Therefore, in situations where existing certificates and statements are not outstanding, or new certificates or statements must be obtained because of a change in circumstances, a withholding agent may obtain new withholding certificates. New withholding certificates will be valid for the period specified in section 1.1441-1(e)(4)(ii) of the final withholding regulations, regardless of when they are obtained.

Notice 97-66 (1997-48 I.R.B. 1) provides a related transition rule that is affected by the extended effective date of the final withholding regulations. Notice 97-66 relates to final Income Tax Regulations on the source and character of substitute interest and dividend payments published in the **Federal Register** on October 14, 1997 as T.D. 8735 (the "final substitute payment regulations"). The notice provides guidance on complying with the statement requirement of section 871(h)(5) for substitute interest payments made after November 13, 1997, or, if an election is made under section 6 of the notice, for substitute interest payments made after December 31, 1998. Substitute interest payments made by a foreign person that are U.S. source interest must satisfy the statement requirement of section 871(h)(5) to qualify as portfolio interest.

The final substitute payment regulations referred taxpayers to §1.871-14(c) of the final withholding regulations for guidance on the statement requirement of section 871(h)(5). Because §1.871-14(c) of the final withholding regulations was not to be effective before January 1, 1999, however, Notice 97-66 provides a transition rule providing that the statement re-

quirement of section 871(h)(5) will be satisfied with respect to substitute interest payments made after November 13, 1997, and before January 1, 1999, if any written, electronic, or oral statement that reasonably establishes that the payee is a foreign person is given or made to the payor before, or within a reasonable period after, the payment.

Because the IRS intends to make §1.871-14(c) of the final withholding regulations effective for payments made after December 31, 1999, as announced herein, the transition rule in Notice 97-66 is extended to apply to substitute interest payments made after November 13, 1997 (or after December 31, 1998, if elected) and before January 1, 2000. The remainder of Notice 97-66 remains unchanged.

On January 26, 1998, a notice of proposed rulemaking (REG-209322-82) was published in the **Federal Register** that would amend regulations under sections 6031 and 6063 regarding the filing of returns of partnership income (a "partnership return"). Under §1.6031(a)-1(b)(2) of the proposed regulations, a partnership return is not required of a foreign partnership if it meets certain conditions and Forms 1042 and 1042-S are filed under §1.1461-1(b) and (c), as amended by the final withholding regulations, either by the partnership or by another withholding agent (or agents). The proposed date of applicability for the exception is taxable years of a partnership that begin on or after January 1, 1999. If §1.6031(a)-1(b)(2) is finalized, Treasury and IRS intend to amend the date of applicability for that section to reflect the extended date of applicability of §1.1461-1(b) and (c) of the final withholding regulations.

#### Section 5. Qualified Intermediary Procedures

As indicated above, for the final withholding regulations to be most effectively implemented, it is desirable for qualified intermediary withholding agreements to be available to as many foreign financial intermediaries as possible. A qualified intermediary is a foreign person, or a foreign branch of a U.S. person, that agrees with the IRS in a qualified intermediary withholding agreement to collect information regarding its account holders and to make that information available as may be required under the agreement. It is an-

anticipated that the qualified intermediary regime will reduce the collection of information and reporting required of withholding agents under the current rules.

Simultaneously with this notice, Treasury and the IRS are releasing Revenue Procedure 98-27, which provides guidance on entering into a qualified intermediary withholding agreement with the IRS. Although the revenue procedure is designed to provide specific guidance on the application process for persons described in §1.1441-1(e)(5)(ii)(A) and (B) (i.e., foreign financial institutions, foreign clearing organizations, and foreign branches of U.S. financial institutions and U.S. clearing organizations), any person desiring a qualified intermediary withholding agreement may submit a draft agreement in the general manner described in the revenue procedure.

This notice announces that, although any person is permitted to apply for and negotiate an individual qualified intermediary withholding agreement with the IRS, the IRS intends to issue a series of model agreements of broad applicability to make qualified withholding agreements as widely available as possible. It is contemplated that, upon release of one of these model agreements, any person falling within the class of persons covered by the model agreement would be able to accept, sign, and submit the agreement to the IRS, without the need for individual negotiations. The IRS currently contemplates that each model agreement will be specific to a particular country, or group of countries with similar laws and practices, and will be specific to a class of persons conducting similar intermediary businesses in a similar manner. Such an approach enables each model agreement to cover as broad a class of persons as possible, while allowing uniform application of all material provisions among all persons in the identified class.

Because of its intent to issue a series of model agreements of broad applicability, the IRS invites submissions of proposed model agreements by groups or associations of potential qualified intermediaries. As part of the submission, the IRS requests a description of the class of persons the proposed model agreement is intended to cover and why that class of persons could operate under a single model agreement.

In the interest of ensuring that as many financial intermediaries as possible can become qualified intermediaries well in advance of the effective date of the final withholding regulations, the IRS intends to give submissions of proposed model agreements of broad applicability first consideration. Consequently, except in unusual circumstances, proposed agreements by individual intermediaries, while also invited, will not likely lead to negotiations with the IRS until sufficient progress has been made in the process of issuing model agreements. Moreover, persons who are clearly within a class of persons covered by an existing model agreement will not be permitted to negotiate an individual agreement absent unusual circumstances.

The IRS currently contemplates releasing a group of model agreements simultaneously, rather than issuing them one-by-one, and expects that this release will occur before December 31, 1998. Additional model agreements and individual agreements may be issued after that first release of model agreements. Due to time constraints, however, groups or associations of intermediaries desiring to submit a proposed model agreement on behalf of a class of persons should make such a submission on or before July 3, 1998, to ensure that such model agreement can be released and individual agreements can be concluded prior to December 31, 1998.

Persons submitting proposed model agreements are advised that these submissions will be made available to the public.

## Section 6. Contact Information

The principal author of this Notice is Carl Cooper of the Office of the Associate Chief Counsel (International) within the Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. For further information regarding this Notice contact Mr. Cooper at 202-622-3840 (not a toll-free call).

## Extension of the Effective Date of the Classification Settlement Program

### Notice 98-21

The Internal Revenue Service is extending the Classification Settlement Pro-

gram or "CSP" until further notice. The CSP is an optional settlement program that allows businesses and tax examiners to resolve worker classification cases as early in the administrative process as possible, thereby reducing taxpayer burden. In the CSP, examiners can offer a business under audit a worker classification settlement using a standard closing agreement developed for this purpose. The CSP procedures also ensure that the taxpayer relief provisions under section 530 of the Revenue Act of 1978 are properly applied.

The Service implemented the CSP in March 1996 on a two-year trial basis. Review of the program and feedback from the public have indicated that the program is successful in facilitating early resolution of cases.

Taxpayer participation in the CSP is entirely voluntary. A taxpayer declining to accept a settlement offer retains all rights to administrative appeal that exist under the Service's current IRS procedures and all existing rights to judicial review.

## DRAFTING INFORMATION

The principal author of this notice is Greg Christensen of the Office of Employment Tax Administration and Compliance. For further information regarding this notice, please contact Mr. Christensen at 202-622-3650 (not a toll-free number).

*26 CFR 601.201: Rulings and determination letters.*

*(Also Part I, Sections 25, 103, 143; 1.25-4T, 1.103-1, 6a.103A-2.)*

## Rev. Proc. 98-28

### SECTION 1. PURPOSE

This revenue procedure provides guidance concerning the United States and area median gross income figures that are to be used by issuers of qualified mortgage bonds, as defined in § 143(a) of the Internal Revenue Code, and issuers of mortgage credit certificates, as defined in § 25(c), in computing the housing cost/income ratio described in § 143(f)(5).

### SECTION 2. BACKGROUND

.01 Section 103(a) provides that, except as provided in § 103(b), gross income does not include interest on any state or

local bond. Section 103(b)(1) provides that § 103(a) shall not apply to any private activity bond that is not a "qualified bond" within the meaning of § 141. Section 141(e) provides that the term "qualified bond" includes any private activity bond that (1) is a qualified mortgage bond, (2) meets the volume cap requirements under § 146, and (3) meets the applicable requirements under § 147.

.02 Section 143(a)(1) provides that the term "qualified mortgage bond" means a bond that is issued as part of a "qualified mortgage issue". Section 143(a)(2)(A) provides that the term "qualified mortgage issue" means an issue of one or more bonds by a state or political subdivision thereof, but only if (i) all proceeds of the issue (exclusive of issuance costs and a reasonably required reserve) are to be used to finance owner-occupied residences; (ii) the issue meets the requirements of subsections (c),(d),(e),(f),(g),(h),(i), and (m)(7) of § 143; (iii) the issue does not meet the private business tests of paragraphs (1) and (2) of § 141(b); and (iv) with respect to amounts received more than 10 years after the date of issuance, repayments of \$250,000 or more of principal on financing provided by the issue are used not later than the close of the first semi-annual period beginning after the date the prepayment (or complete repayment) is received to redeem bonds that are part of the issue.

.03 Section 143(f) imposes eligibility requirements concerning the maximum income of mortgagors for whom financing may be provided by qualified mortgage bonds. Section 25(c)(2)(A)(iii)(IV) provides that recipients of mortgage credit certificates must meet the income requirements of § 143(f). Generally, under §§ 143(f)(1) and 25(c)(2)(A)(iii)(IV), these income requirements are met only if all owner-financing under a qualified mortgage bond and all certified indebtedness amounts under a mortgage credit certificate program are provided to mortgagors whose family income is 115 percent or less of the applicable median family income. Under § 143(f)(6), the income limitation is reduced to 100 percent of the applicable median family income if there are fewer than three individuals in the family of the mortgagor.

.04 Section 143(f)(4) provides that the term "applicable median family income"

means the greater of (A) the area median gross income for the area in which the residence is located or (B) the statewide median gross income for the state in which the residence is located.

.05 Section 143(f)(5) provides for an upward adjustment of the income limitations in certain high housing cost areas. Under § 143(f)(5)(C), a high housing cost area is a statistical area for which the housing cost/income ratio is greater than 1.2. The housing cost/income ratio is determined under § 143(f)(5)(D) by dividing (a) the applicable housing price ratio by (b) the ratio that the area median gross income bears to the median gross income for the United States. The applicable housing price ratio is the new housing price ratio (new housing average purchase price for the area divided by the new housing average purchase price for the United States) or the existing housing price ratio (existing housing average area purchase price divided by the existing housing average purchase price for the United States), whichever results in the housing cost/income ratio being closer to 1. This income adjustment applies only to bonds issued and nonissued bond amounts elected after December 31, 1988.

.06 The Department of Housing and Urban Development (HUD) has computed the median gross income for the United States, the states, and statistical areas within the states. The income information was released to the HUD regional offices on January 7, 1998, and may be obtained by calling the HUD reference service at 1-800-245-2691, or, in the Washington, D.C., area, at 301-251-5154. The Internal Revenue Service annually publishes only the median gross income for the United States.

.07 The most recent nationwide average purchase prices and average area purchase price safe harbor limitations were published on September 6, 1994, in Rev. Proc. 94-55, 1994-2 C.B. 716.

### SECTION 3. APPLICATION

.01 When computing the housing cost/income ratio under § 143(f)(5), issuers of qualified mortgage bonds and mortgage credit certificates must use \$45,300 as the median gross income for the United States. See section 2.06 of this revenue procedure.

.02 When computing the housing cost/income ratio under § 143(f)(5), issuers of qualified mortgage bonds and mortgage credit certificates must use the area median gross income figures released by HUD on January 7, 1998. See section 2.06 of this revenue procedure.

### SECTION 4. EFFECT ON OTHER REVENUE PROCEDURES

.01 Rev. Proc. 97-26, 1997-17 I.R.B. 17, is obsolete except as provided in section 5.02 of this revenue procedure.

.02 This revenue procedure does not affect the effective date provisions of Rev. Rul. 86-124, 1986-2 C.B. 27. Those effective date provisions will remain operative at least until the Service publishes a new revenue ruling that conforms the approach to effective dates set forth in Rev. Rul. 86-124 to the general approach taken in this revenue procedure.

### SECTION 5. EFFECTIVE DATES

.01 Issuers must use the United States and area median gross income figures specified in section 3 of this revenue procedure for commitments to provide financing that are made, or (if the purchase precedes the financing commitment) for residences that are purchased, in the period that begins on January 7, 1998, the date HUD released the income figures, and ends on the date when these United States and area median gross income figures are rendered obsolete by a new revenue procedure.

.02 Notwithstanding section 5.01 of this revenue procedure, issuers may continue to rely on the United States and area median gross income figures specified in Rev. Proc. 97-26 with respect to bonds originally sold and nonissued bond amounts elected not later than May 13, 1998, if the commitments or purchases described in section 5.01 are made not later than July 13, 1998.

### DRAFTING INFORMATION

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### SECTION 1. PURPOSE AND SCOPE

.01 *Purpose.* This revenue procedure gives guidance for entering into a withholding agreement with the Internal Revenue Service (IRS) to be treated as a Qualified Intermediary (QI) under §1.1441-1(e)(5) of the Income Tax Regulations. It describes the application procedures for becoming a QI and the terms that the IRS will ordinarily require in a QI withholding agreement. The objective of a QI withholding agreement is to simplify withholding and reporting obligations with respect to payments of income (including interest, dividends, royalties, and gross proceeds) made to an account holder through one or more foreign intermediaries.

.02 *Scope.* This revenue procedure applies to persons described in §1.1441-1(e)(5)(ii)(A) and (B)—foreign financial institutions, foreign clearing organizations, and foreign branches of U.S. financial institutions and U.S. clearing organizations. It does not apply to foreign corporations seeking to become a QI to present claims of benefits under an income tax treaty on behalf of shareholders. See §§1.1441-1(e)(5)(ii)(C) and 1.1441-6(b)(4)(ii)(B). It does not apply to a foreign partnership seeking to qualify as a withholding foreign partnership. See §1.1441-5(c)(2)(ii). It also does not apply to other persons that the IRS may accept to be qualified intermediaries as authorized under §1.1441-1(e)(5)(ii)(D). A person that is not within the scope of this revenue procedure but may seek QI

status under §1.1441-1(e)(5)(ii)(C) or (D), or §1.1441-5(c)(2)(ii) should contact the Office of the Assistant Commissioner (International) at the address or telephone number in section 4.01 of this revenue procedure.

## SECTION 2. BACKGROUND

.01 *Withholding and reporting on payments to foreign persons.* Under sections 1441 and 1442 of the Internal Revenue Code (Code), a person that makes a payment of U.S. source interest, dividends, royalties, and certain other types of income to a foreign person must generally deduct and withhold 30 percent from the payment. A lower rate of withholding may apply under the Code (e.g., section 1443), the regulations, or an income tax treaty. Generally, a payor of these types of income must also report the payments on Form 1042-S. See §1.1461-1(c).

Under sections 6042, 6045, 6049, and 6050N of the Code (the Form 1099 reporting provisions), payors of dividends, gross proceeds, interest, and royalties must report the payments on Form 1099 unless an exception applies. If a payor must report a payment on Form 1099, it must obtain a Form W-9 from the payee. If the payor does not receive the Form W-9, it must backup withhold at a 31-percent rate under section 3406 of the Code. One exception to the Form 1099 reporting provisions applies if the payee is a foreign person. A payor can treat a person as foreign if the payor can reliably associate the payment with documentation that establishes that the person is a foreign beneficial owner of the income or a foreign payee. See §§1.6042-3(b)(1)-(iii), 1.6045-1(g)(1)(i), 1.6049-5(b)(12), and 1.6050N-1(c)(1)(i). Moreover, a payor does not have to backup withhold on payments to foreign beneficial owners or foreign payees because backup withholding applies only to amounts that the payor must report on Form 1099.

.02 *Proof of foreign status.* The regulations under section 1441 and the Form 1099 reporting provisions of the Code prescribe the manner in which a beneficial owner or payee certifies to a payor that it is a foreign or U.S. person and, if foreign, whether a reduced rate of withholding applies. For proof of foreign status, a payor or a withholding agent may rely on a Form W-8 or on documentary

evidence for payments made outside the United States to an offshore account or, in the case of broker proceeds, a sale effected outside the United States.

In addition, a payor or withholding agent may rely on a QI's certifications (as described in §1.1441-1(e)(3)(ii) and section 5.02 of this revenue procedure) to determine whether a beneficial owner or payee is foreign, and to determine the applicable rate of withholding and the appropriate type of reporting. The QI provides its certifications on a Form W-8. By furnishing its own Form W-8 to a payor or withholding agent, a QI may, for example, act on behalf of its foreign account holders to claim a reduction of the 30-percent withholding rate without having to document or identify to the withholding agent each foreign account holder individually.

## SECTION 3. DEFINITIONS

For purposes of this revenue procedure, the terms listed below are defined as follows.

.01 A "QI" is an eligible person as described in §1.1441-1(e)(5)(ii)(A) or (B) (and paragraph .10 of this section) that enters into a withholding agreement (described in section 5 of this revenue procedure) with the IRS. A person acting in its capacity as a QI does not act as an agent of the IRS, nor does it have the authority to hold itself out as an agent of the IRS.

.02 A "QI-Form W-8" means a withholding certificate described in §1.1441-1(e)(3)(ii).

.03 An "account holder" means any person that has an account with a QI. It includes a person that is the beneficial owner of the account or a person that holds the account as an intermediary (e.g., custodian, nominee or agent).

.04 An "exempt recipient" means, for interest, dividends, and royalties, a person described in §1.6049-4(c)(1)(ii). For broker proceeds, it is a person described in §5f.6045-1(c)(3)(i)(B) or in §1.6045-2(b)(2)(i).

.05 A "non-exempt recipient" or "non-exempt payee" means a person that is not an exempt recipient under the definition in paragraph .04 of this section.

.06 Any reference to "chapter 3 of the Code" means sections 1441, 1442, and 1443 of the Code, and shall not include references to sections 1445 and 1446 of

the Code, unless specifically indicated otherwise.

.07 Any reference to "chapter 61 of the Code" means sections 6041, 6041A, 6042, 6044, 6045, 6049, and 6050N of the Code.

.08 A "reportable amount" means an amount subject to withholding under chapter 3 of the Code (within the meaning of §1.1441-2(a)), U.S. source deposit interest (including original issue discount) described in section 871(i)(2)(A) of the Code, and U.S. source interest or original issue discount on short-term obligations described in section 871(g)(1)(B) of the Code. The term does not include payments on deposits with banks and other financial institutions that remain on deposit for two weeks or less. It also does not include amounts of original issue discount arising from a sale and repurchase transaction completed within a period of two weeks or less, or amounts described in §1.6049-5(b)(7), (10), or (11) (relating to certain obligations issued in bearer form). See §1.1441-1(e)(3)(vi).

.09 A "withholding agent" has the same meaning as set forth in §1.1441-7(a) and includes a payor, as defined in §1.6049-4(a)(2). As used in this revenue procedure, the term generally refers to the person making a payment to a QI.

.10 An "eligible person" means, as described in §1.1441-1(e)(5)(ii)(A) or (B), any foreign financial institution, foreign clearing organization, or foreign branch of a U.S. financial institution or U.S. clearing organization.

.11 A "branch" includes an office.

.12 A "financial institution" means a person described in §1.165-12(c)(1)(iv) (not including a person providing pension or other similar benefits or a regulated investment company or other mutual fund, unless otherwise indicated).

.13 A "clearing organization" means a person described in §1.163-5(c)(2)(i)-(D)(8).

.14 "Class of assets" and "withholding pool," have the meanings given to the terms in section 5.02(4)(c) of this revenue procedure.

.15 Any reference to "payments to a QI or an account holder" includes crediting an amount to the account of the QI or account holder.

.16 An "acceptance agent" is a person, as described in §301.6109-1(d)(3)(iv)(B),



that is authorized to assist persons in obtaining individual taxpayer identification numbers or employer identification numbers from the IRS. See Rev. Proc. 96-52, 1996-2 C.B. 372.

#### **SECTION 4. APPLICATION FOR QI STATUS AND WITHHOLDING AGREEMENT**

.01 *Where to Apply and Pre-submission Conferences.* To apply for QI status and a withholding agreement, an eligible person must submit a written request to:

Assistant Commissioner (International), CP:IN:OO:WT 950 L'Enfant Plaza South, SW  
Washington DC 20024  
FAX: (202) 874-1797

An eligible person may request one or more pre-submission conferences by contacting the Office of the Assistant Commissioner (International) at (202) 874-1800 (not a toll-free number).

.02 *Content of Application.* The application must establish to the satisfaction of the IRS that the applicant has adequate resources and procedures to comply with the terms of a withholding agreement. An application must include the information specified in this section 4.02, and any additional information and documentation requested by the IRS.

(1) A statement that the applicant is an eligible person and that it requests a QI withholding agreement with the IRS.

(2) The applicant's name, address, and employer identification number (EIN), if any.

(3) The country in which the applicant was created or organized and a description of the applicant's business.

(4) A list of the applicant's officers and directors and a list of the employees who are responsible parties for performance under the agreement.

(5) A list of the branches that the agreement will cover and their location.

(6) An explanation and sample of the account opening agreements and other documents used to open and maintain the accounts at each location covered by the agreement.

(7) The type of account holders (e.g., U.S., foreign, treaty benefit claimant, or intermediary), the approximate number of account holders within each type, and the estimated value of U.S. investments that the QI-Form W-8 will cover.

(8) An explanation of the applicant's "know-your-customer" practices and procedures (under its local money-laundering laws) for opening accounts, and identifying and communicating with customers at each location covered by the agreement. The explanation should include whether local law mandates the "know-your-customer" procedures and the manner in which local authorities verify compliance. The applicant should also describe the governmental or other supervisory authorities that regulate the "know-your-customer" procedures, and the sanctions that apply under local law for failing to comply with the procedures. The applicant must include supporting documentation.

(9) A list of assets in the United States from which amounts owed to the IRS can be collected, if necessary.

(10) A completed Form SS-4 (Application for Employer Identification Number) to apply for a QI Employer Identification Number (QI-EIN) to be used solely for QI reporting and filing purposes. An applicant must apply for a QI-EIN even if it already has another EIN.

(11) A proposed QI withholding agreement drafted in accordance with section 5 of this revenue procedure.

#### **SECTION 5. QI WITHHOLDING AGREEMENT**

.01 *Scope of the agreement.* An agreement may not cover U.S. branches of an eligible person. An eligible person is not required to include all of its foreign branches in the agreement. The IRS may require, however, that an eligible person agree to include certain of its branches to insure the disclosure of certain U.S. account holders. See §1.1441-1(e)(5)(iii) and section 5.02(3), below. In appropriate cases, an eligible person may request that the agreement cover its related non-U.S. affiliates or unrelated account holders that act as nominees, custodians, or agents of beneficial owners. If the IRS grants the request, each related non-U.S. affiliate or unrelated account holder must agree to be a signatory to the agreement.

.02 *Terms and procedures regarding intermediary withholding certificate.* (1) *Submission of QI-Form W-8.* The agreement must specify that a QI will furnish its QI-Form W-8, with its QI-EIN, to withholding agents for reportable amounts in lieu of furnishing a Form W-8

or Form W-9 from each of its account holders to such withholding agents.

(2) *Designation of primary withholding responsibility.* A QI is a withholding agent under chapter 3 of the Code and a payor under chapter 61 and section 3406 of the Code for reportable amounts that it pays to its account holders. Generally, a withholding agent that makes a payment to the QI, however, will be responsible for actually withholding under chapter 3 and section 3406 of the Code. Thus, if the withholding agent has withheld and reported on the reportable amounts paid to the QI, the QI is not required to withhold except to the extent required to correct any under-withholding. See §1.1441-1(b)(6). The QI may, however, agree in its withholding agreement to assume primary withholding responsibility for payments to foreign account holders. See §1.1441-1(e)(5)(iv). Generally, the IRS will not allow a QI to assume primary withholding or reporting responsibility for payments to U.S. persons unless the QI is a foreign branch of a U.S. financial institution, or the QI has a branch in the United States and establishes that its U.S. branch can adequately comply with the provisions under chapter 61 and section 3406 of the Code.

(3) *Disclosure of identity of beneficial owner or payee by QI.* Except as otherwise provided in this subparagraph (3), a QI is not required to disclose the identity of its account holders covered by a QI-Form W-8 to a withholding agent. Further, the documentation given by an account holder to a QI supporting the account holder's claim of foreign status and, if applicable, entitlement to a reduced rate of withholding does not need to be attached to the QI-Form W-8. The QI must, however, furnish a Form W-9 (or an acceptable substitute form) for each of its account holders (or those of another intermediary or of a foreign partnership) that is a U.S. payee that is not an exempt recipient. The identity of U.S. payees who are exempt recipients is not required to be disclosed to the withholding agent. If the QI does not hold a Form W-9 for a non-exempt U.S. payee, it must furnish to the withholding agent any information the QI has regarding the payee's name, address, and taxpayer identifying number. The requirement to disclose the identity of non-exempt U.S. payees will apply despite local bank secrecy laws.

(4) *Information to withholding agent.* (a) *In general.* A QI must agree to identify the classes of assets covered by the QI-Form W-8 by following §1.1441-1(e)(5)(v) and subparagraph (4)(c) of this section. In addition, the QI must state the rate of withholding for each class.

(b) *Application of presumptions.* To identify the relevant classes of assets, a QI may determine the status of its, or another intermediary's, account holders by following the presumptions in §§1.1441-1(b)(3), 1.1441-5(d) and (e), and 1.6049-5(d)(2) through (d)(5).

(c) *Class of assets and withholding pool.* (i) *Definition.* Generally, a class of assets is a group of assets that produces the same type of income (e.g., interest or dividends), is subject to the same rate of withholding, and is associated with the same type of payee or beneficial owner (e.g., foreign, U.S., or undocumented (i.e., a payee for whom the QI holds no or unreliable documentation)). Notwithstanding the general rule that a class of asset should produce the same type of income, a QI-Form W-8 may state that all assets held in a particular account are within a single class of assets if all the income from the assets in such account is subject to the same rate of withholding and the same type of information reporting. See, for example, subparagraph (4)(c)(ii)(C) of this section. The QI withholding agreement must require the QI to identify classes of assets on a country-by-country basis. The income from each class of assets is a separate "withholding pool." See section 5.07(3) for more information on withholding pools.

(ii) *Application.* (A) *Foreign payees.* Assets that are associated with foreign payees, that produce a specific type of income, and are subject to a particular withholding rate are a class of assets. Thus, there may be numerous classes of assets for the same type of income paid to foreign payees because of different withholding rates under the Code or an applicable treaty.

(B) *U.S. payees.* Assets associated with each U.S. payee that is a non-exempt recipient are a separate class. Assets associated with all U.S. payees that are exempt recipients are a single separate class.

(C) *Undocumented payees.* Assets associated with undocumented payees con-

stitute a separate class. A QI paying reportable amounts (other than U.S. source bank deposit interest or short-term OID) must presume that undocumented payees of those amounts are foreign unless the QI has actual knowledge that the payee is a U.S. non-exempt recipient. For reportable amounts that are bank deposit interest from a U.S. branch of a U.S. bank or similar financial institution or short-term original issue discount, the QI must presume that the undocumented payee is a U.S. non-exempt recipient.

(D) *QI assuming primary withholding responsibility.* Assets for which a QI assumes primary withholding responsibility are a separate class. The QI does not have to identify separate classes of assets within that class if the assumption of withholding responsibility makes such a disclosure unnecessary. The QI withholding agreement may, however, require a QI to identify the assets with respect to which it assumes primary withholding responsibility on a country-by-country basis.

(iii) *Example.* (A) *Facts.* A QI ("QI1") has foreign account holders. The QI1 also has account holders that are U.S. non-exempt recipients. Another account holder is a QI ("QI2") that has assumed primary withholding responsibility. Finally, QI1 has some account holders for whom it does not have the required documentation. QI1 has not assumed primary withholding responsibility for any assets.

All account holders earn U.S. source interest that would qualify as portfolio interest if they gave the documentation required by §1.871-14(c)(2). They also earn U.S. source dividends. Some of the foreign account holders can benefit from a 15-percent reduced withholding rate under a tax treaty on dividend income while others cannot.

(B) *Analysis.* QI1 has the following classes of U.S. source assets and withholding pools:

(1) assets producing interest earned by foreign account holders claiming the portfolio interest exemption at source (a withholding pool of interest - zero rate);

(2) assets producing dividend income earned by foreign account holders claiming the 15-percent reduced rate at source under an income tax treaty (a withholding pool of dividends - 15% rate);

(3) assets producing dividend income earned by foreign account holders resid-

ing in a non-treaty country (a withholding pool of dividends - 30% rate);

(4) assets producing interest income earned by each U.S. account holder (a withholding pool per account holder of interest reportable on a Form 1099 - zero rate);

(5) assets producing dividends earned by each U.S. account holder (a withholding pool per account holder for dividends reportable on a Form 1099 - zero rate);

(6) assets producing dividends and interest income earned by account holders for whom the QI1 does not hold all of the required documentation as specified under the agreement (a withholding pool for undocumented payees - 30% rate (presumed foreign)—Note: QI1 could divide this class of assets into one for dividends and another for interest income); and

(7) assets producing dividends and interest payable to QI2 for its foreign account holders (a withholding pool for which QI2 assumes withholding).

.03 *Documentation requirements.* (1) *In general.* The agreement must contain provisions covering the type of documentation a QI will obtain from its account holders. Generally, the QI must agree to the same documentation requirements that apply to withholding agents under chapters 3 and 61 of the Code. The QI may use any substitute form for a Form W-8 or Form W-9 that is acceptable to the IRS. The QI may include a substitute form in an account opening form. If a QI relies on documentary evidence in place of a Form W-8, the agreement must specify the type of documentary evidence upon which the QI may rely.

(2) *Documentary evidence from beneficial owners.* Beneficial owner documentary evidence is acceptable if the QI complies with the provisions of §1.6049-5(c)(1). Generally, a QI will be permitted to rely on the "know-your-customer" procedures (as submitted for review pursuant to section 4.02(8) of this revenue procedure) if such procedures are acceptable to the IRS.

(3) *Documentation supporting claim of reduced rate.* A QI may not reduce the rate of withholding, or instruct a withholding agent to reduce the rate, unless it can associate the payment with valid documentation described in the section 1441 regulations or in the QI withholding agreement. If an account holder is not an

individual, the QI must obtain a certification that the account holder meets the Limitations on Benefits article contained in any treaty the account holder invokes. See §1.1441-6(c)(5). If an account holder, other than an individual, is acting for its own account, the QI must also obtain a representation that the account holder is not a partnership for U.S. tax purposes. If the account holder is a partnership for U.S. tax purposes, then the QI must obtain a Form W-9 as described in §1.1441-1(d)(2) (if the partnership is a domestic partnership) or a Form W-8 as described in §1.1441-5(c) (if the partnership is a foreign partnership). In addition, if an account holder, other than an individual, claims the benefit of a reduced rate of withholding under a tax treaty, the QI must obtain the representations set forth in §§1.1441-6(b)(4)(i) and 1.894-1T(d).

(4) *Documentation from intermediaries.* When the QI receives a payment of a reportable amount for an account holder that is an intermediary (e.g., nominee, custodian, or agent), the QI must obtain beneficial owner documentation in the following manner:

(a) *Intermediary that is not a QI.* If the intermediary is not a QI, then the intermediary must give the QI a Form W-8 according to §1.1441-1(e)(3)(iii), including a statement described in §1.1441-1(e)(3)(iv) regarding the allocation of payments. A QI that receives a non-QI intermediary Form W-8 may either give the non-QI intermediary Form W-8, with all the accompanying documentation, to the withholding agent or may use the non-QI intermediary Form W-8 as the basis for the certifications that the QI includes in its own QI-Form W-8 regarding the status of, and entitlement to benefits by, the non-QI intermediary's account holders.

(b) *Intermediary that is a QI.* If the intermediary is a QI (i.e., a second tier QI), the second tier QI must give the first tier QI a QI-Form W-8. The first tier QI may give the second tier QI's QI-Form W-8, and accompanying documentation, to the withholding agent. Alternatively, the first tier QI may use the second tier's QI-Form W-8 as the basis for the certifications that the first tier QI includes in its own QI-Form W-8 regarding the status of, and entitlement to benefits by, the second tier QI's account holders. If the first tier QI relies on the second tier QI's QI-

Form W-8 to certify to the withholding agent the withholding status of the second tier QI's account holders, then the first tier QI must agree to allocate the assets associated with the second tier QI's QI-Form W-8 to the classes that the first tier QI has established for its own account holders as if the account holders of the second tier QI were the first tier QI's own account holders.

(c) *Assumption of primary withholding responsibility.* If a QI has assumed primary withholding responsibility, it must generally assume that responsibility for all other intermediaries, whether or not they are QIs, that are before it in the chain of payment. If a second tier QI has agreed to assume primary withholding responsibility, then a first tier QI that has also assumed primary withholding responsibility does not have to withhold on income paid to the second tier QI. If the second tier QI has assumed primary withholding responsibility but the first tier QI has not, the first tier QI must agree to identify for the withholding agent those assets associated with the second tier QI's QI-Form W-8 and on which there should be no withholding (other than under section 3406 of the Code, if applicable). See example under paragraph .02(4)(c)(iii), above.

(5) *Standards of reliability and due diligence.* A QI must agree to follow the due diligence obligations of §1.1441-7(b)(2)(ii). The reliability of any documentation will be evaluated by the type of information contained in the documents, the procedures under which the documents are issued, and the ease with which the documents could be falsified.

(6) *Renewal of documentation.* Unless specified otherwise in the agreement, a QI must agree to follow the provisions of §1.1441-1(e)(4)(ii) regarding the renewal of the Forms W-8 and documentary evidence provided by its account holders.

.04 *Assistance regarding taxpayer identification numbers.* (1) *Acceptance agents.* A QI may agree to act as an acceptance agent, including a certifying acceptance agent, for purposes of section 6109 of the Code and the regulations thereunder. See Rev. Proc. 96-52, 1996-2 C.B. 372, for the duties and obligations of an acceptance agent.

(2) *TIN certifications.* A QI may agree to assist its account holders in complying

with the requirements for a certified TIN under §1.1441-6(b). Only account holders claiming a reduced rate under an income tax treaty for certain payments (e.g., income from non-publicly traded securities) are required to obtain a certified TIN. See §1.1441-6(b)(1) and (2)(i).

.05 *Recordkeeping obligations.* The agreement must provide that the QI will maintain a record of the documentation obtained and reviewed under the agreement. The QI must maintain the documentation for any account holder for a period of three years after its validity expires. The documentation must also be available for inspection by the IRS or, if applicable, an approved external auditor.

.06 *Withholding obligations.* (1) *QI assumes primary withholding responsibility.* A QI that assumes primary withholding responsibility must agree to withhold any amount due under section 1441, 1442, or 1443 of the Code in accordance with §1.1441-1(b)(1) and §1.1443-1(b). If applicable, the QI must also agree to withhold any amount due under section 3406 of the Code. In addition, the QI must agree to deposit the withheld amounts following §1.1461-1(a) and all other relevant deposit obligations. Under the agreement, the IRS may agree to special deposit procedures to facilitate remittances from a foreign country.

(2) *QI that does not assume primary withholding responsibility.* A QI that does not assume primary withholding responsibility nevertheless must agree to withhold if it knows that an amount should have been withheld from the payment and the full amount was not withheld. The QI must also agree to comply with withholding and deposit procedures in the same manner as described in paragraph .06(1) of this section for amounts that it withholds.

.07 *Reporting obligations.* (1) *In general.* The regulations under section 1461 of the Code require a QI to make returns on a Form 1042 and to provide information to the IRS and beneficial owners or payees on a Form 1042-S on a calendar year basis under the provisions of §1.1461-1(b), subject to the following modifications to which the IRS may agree.

(2) *Form 1042 reporting.* Generally, every QI shall file an annual Form 1042 and the form must include the following additional information:

(a) A schedule providing information on reportable amounts of income subject to withholding under chapter 3 of the Code that the QI received during the calendar year. The schedule should list the name, address, and EIN of each withholding agent from whom the reportable amounts were received and the income type and rate of withholding;

(b) Information regarding overpayments or balances due, adjustments under §1.1461-2 and an explanation for the over- or underwithholding;

(c) A statement regarding the audit conducted by the QI's internal auditors under the audit guidelines specified in the agreement (i.e., that the QI is complying with the agreement in all material respects or a description of the irregularities uncovered by the internal auditors and the actions undertaken to correct such irregularities); and

(d) A statement that an approved external auditor conducted an audit, when required, with a copy of the report of audit findings (see paragraph .09 of this section regarding verification procedures).

(3) *Form 1042-S reporting.* The agreement may waive the obligation for a QI to report beneficial owner information to the IRS on Forms 1042-S in appropriate cases. In place of beneficial owner information, the IRS may require the QI to report by country and withholding pools. An appropriate case may exist if beneficial owner information is otherwise available to the IRS, for example, pursuant to treaty exchange of information provisions, or the IRS decides that access to beneficial owner information is not necessary for compliance. Similarly, reporting by withholding pools may be sufficient for compliance purposes if the QI has agreed to adequate verification procedures as described in paragraph .09 of this section. The QI may provide the information on a Form 1042-S, as modified by the IRS to adapt to the withholding pool reporting requirements, on magnetic media, by electronic means, or on any form to which the IRS and the QI agree. The information must include the number of account holders in each pool. The type of withholding pool subdivisions the IRS may require for the payment of reportable amounts under chapter 3 of the Code (within the meaning of §1.1441-2(a)) includes the following:

(a) Type of income;

(b) Withholding rate;

(c) Country of residence of account holder; and

(d) Type of recipients (e.g., undocumented payees, U.S. payees).

(4) *Furnishing a Form 1042-S to the beneficial owner or payee.* The agreement may modify or waive the obligation under §1.1461-1(c)(1)(i) that the QI furnish a statement to a beneficial owner or payee on a Form 1042-S and provide for alternative reporting procedures.

(5) *Reports related to claims of a reduced rate under a tax treaty.* The QI must agree to give the IRS, on request or on an annual basis, the names and addresses of its account holders that received a reduced rate of withholding under a tax treaty and that have certified that they meet the Limitation on Benefits provision and that they derive, within the meaning of §1.894-1T(d), the income receiving the benefit. The QI must also agree to disclose the names and addresses of account holders of any non-QI intermediary that has given the QI a Form W-8 or other documentation if the account holders have certified that they meet the Limitation on Benefits provision of a treaty and derive the income receiving the benefit. Generally, the IRS will agree to limit disclosure to account holders that receive more than an agreed upon amount (not less than \$100,000) of treaty-benefited income in their QI account.

.08 *Adjustments for under- and overwithholding, refund procedures, and underwithholding determined after the filing of Form 1042.* (1) *Adjustments.* If a QI has not assumed primary withholding responsibility, it must agree that it will provide sufficient information to a withholding agent so that the withholding agent can make the adjustments for over- and under-withholding described in §1.1461-2(a) and (b). If a QI has assumed primary withholding responsibility, it may make the adjustments itself in the manner described under §1.1461-2(a) and (b).

(2) *Refunds.* A QI withholding agreement may allow any net amount of overwithholding for a calendar year on a QI's account holders which remains outstanding after the due date for filing the QI's Form 1042 (not including extensions) to be refunded to the QI for its account holders (under procedures as the IRS may pre-

scribe) if an adjustment under §1.1461-2(a) cannot be made.

(3) *Underwithholding determined after filing a QI's Form 1042.* A QI, including a QI that does not assume primary withholding responsibility, must agree to file an amended Form 1042 to report any underwithheld tax which is determined after the filing of the QI's Form 1042 for the calendar year in which the tax was underwithheld. In addition, the QI must agree to pay the tax due (including interest and penalties). This includes, but is not limited to, instances where the underwithholding is determined as a result of an audit by the QI's internal or external auditors.

.09 *Verification procedures.* (1) *In general.* Unless the QI agreement allows for verification by an external auditor, a QI must agree to make records and account information specified in the QI withholding agreement available to the IRS for audit, and must agree to procedures for carrying out an audit of those records and information. The IRS must be able to verify that the QI has adequate systems and control procedures in effect to comply with the agreement. In addition, the IRS may require specific procedures to allow it to verify compliance with the QI withholding agreement for specific accounts.

(2) *Verification of specific account information.* If a QI is not subject to audit under the approved external auditor procedure, described in paragraph .10(3) of this section, then the QI withholding agreement will contain procedures for IRS audits of account information. Generally, a QI that complies with the filing requirements on Forms 1042 and 1042-S (or otherwise makes account holder information available to the IRS) may be exempted from IRS audits or be subject to abbreviated IRS audits. If a QI has agreed to certify tax residence to the IRS under §1.1441-6(c)(2)(iii) based upon documentation the QI has obtained and reviewed, it must also agree to give the documentation to the IRS upon written request in the manner agreed. To conduct periodic compliance checks, the IRS may rely on sampling techniques to assure reliability of the examination without undue disruption to the QI. The agreement will specify the manner in which IRS compliance checks will take place. In appropriate cases, assistance may be

obtained from the tax authorities of the countries where the QI activities are located.

(3) *Approved external auditors.* If, given local enforcement of know-your-customer procedures and local oversight and controls over the QI and its external auditors, the IRS determines it is appropriate, the following procedures will generally apply under the agreement.

(a) The QI must establish that it has implemented adequate internal procedures and accounting systems to comply with the QI withholding agreement and to verify its compliance with those procedures. Internal auditors must review those procedures and accounting systems on an annual basis as a regular part of their audit program. Their conclusions must be included in their annual audit report. A statement certifying that the annual review has taken place and the results of that review (including a notation of all irregularities observed and actions taken to address those irregularities) must be attached to the QI's annual Form 1042 filed with the IRS.

(b) Verification must also be performed by external auditors. The QI must agree to an external auditor's review after the first year of operation as a QI. Thereafter, the frequency and scope of compliance checks by external auditors will occur only at the request of the IRS, generally based upon a review of the QI's Form 1042 or indicators that the QI may have compliance problems (e.g., large refund requests, large pool of undocumented payees). The scope of review by external auditors may be limited based on the scope of annual internal audits. In order for the external auditors to perform their audit effectively, the QI must agree to allow external auditors to have access to all of its relevant records for purposes of performing the audits.

(c) The external auditor must be approved by the IRS and designated in the QI withholding agreement. Subsequent changes of external auditors must also be approved by the IRS. To be approved, an auditor must be subject to regulatory supervision under the laws of the country or countries in which the QI's activities under the agreement are expected to occur. The external auditor's procedures must require it to verify that the QI complies with the terms of the agreement and

to report non-compliance findings under the agreement.

(d) Upon completion of the audit, the external auditors must issue a report of audit findings (or incorporate their audit findings as a separate part of a larger audit report) and provide the report to the IRS in English (and using U.S. dollars). The report must explain the scope and objectives of the audit, state the methodology used, and certify that the audit was conducted in accordance with applicable laws and regulatory requirements. The report must express the auditor's opinion on the QI's compliance with the terms of the agreement. The QI and the approved external auditor must agree to allow the IRS to communicate with the external auditors and review their workpapers, if necessary. If the external auditor's report identifies compliance issues or if, based on a review of the external auditor's report, the IRS determines that further checks are necessary, then the IRS may request that the external auditor perform additional audit procedures.

(4) *Special rules for foreign branches of U.S. financial institutions.* Generally, a QI that is a foreign branch of a U.S. financial institution will be subject to the same IRS audit procedures that apply to any U.S. taxpayer.

.10 *Guarantee of payment.* To insure collection of payments for underwithheld amounts, the agreement may require a guarantee to be furnished by the QI to the IRS. The guarantee may include a letter of credit, bond, or other surety in an amount to which the QI and the IRS agree. The amount of the bond or letter of credit must be commensurate with the approximate risk of underwithholding. Factors to be considered in this regard include the amount of U.S. investments made through the QI, the number of beneficial owners making U.S. investments, the type of investment and the characteristics of the beneficial owners, and the degree of reporting by the QI to the IRS. Generally, a QI that has substantial assets in the United States will be considered to have adequately guaranteed its withholding obligations.

.11 *Approval and Execution.* An agreement must be signed by the authorized representative of the QI and by the IRS. The Assistant Commissioner (International) will sign on behalf of the IRS upon

approval by the Associate Chief Counsel (International). To the extent an agreement covers a QI's related non-U.S. affiliate or unrelated account holder, that affiliate or account holder must be a signatory to the agreement.

.12 *Expiration, Termination and Default.* (1) *Term and events of termination.* The period of the agreement will be between three and six years. The agreement may be renewed for further periods as specified in paragraph .13 of this section. Either the IRS or the QI may terminate the agreement prior to its term by delivering a 30-day notice of termination to the other party. The IRS will not give notice of termination until thirty days after it has delivered a notice of default to the QI. The IRS may deliver a notice of default at any time after an event of default under the agreement has occurred or after a significant change in the circumstances of the QI has occurred such as a merger, changes in the business or operations of the QI, or bankruptcy.

(2) *Events of default.* Events of default include the determination upon audit or otherwise that the QI has failed to comply with the procedures required by the agreement in a way that (1) causes, or may cause, significant underwithholding, excessive refunds, or an excessive number of undocumented payees, or (2) impedes, or may impede, the disclosure of the identity of persons who are required to be disclosed under the agreement. An event of default also includes the lack of cooperation by the QI or an approved external auditor in connection with an audit of the QI or with inquiries by the IRS related to verifying compliance by the QI. The agreement will define when underwithholding or inadequate reporting is deemed to be significant. A QI will also be in default if it makes material misrepresentations on its Form W-8; it has actual knowledge at the time a payment is made that documentation regarding a significant number of account holders is lacking, incorrect, or unreliable; or it fails to perform any other material duty or obligation required of it under the agreement. The QI may respond to the notice of default by making an offer to cure within thirty days. The IRS will accept or reject the offer to cure, or make a counter-proposal, within ten days.

.13 *Renewal.* A QI may renew a QI withholding agreement by submitting an

application for renewal to the IRS no earlier than one year and no later than six months prior to the expiration of the agreement. In the application for renewal, the QI will update the information it provided in the original application. Before approval of any renewal of the agreement, the IRS will require an audit of the QI.

.14 *Effective date of agreements.* The agreements entered into under §1.1441-1(e)(5) will be effective for all accounts opened on or after the date specified in the agreement. For accounts existing on the effective date of the agreement, the requirements to obtain documentation generally will not apply until the expiration of the one-year period beginning on the agreement's effective date. Until the documentation is obtained for these accounts, the QI generally will be permitted to rely on any documentation or information in an existing account file. In the absence of any documentation or indication, or actual knowledge, the QI will be allowed to presume that an account holder is a foreign person based on the indicia of foreign status described in §1.1441-1(b)(3)(iii)(A). The presumption shall not be effective for purposes of obtaining the benefit of the portfolio interest exemption under section 871(h) or 881(c) of the Code or the benefit of a tax treaty.

## SECTION 6. EFFECTIVE DATE

This revenue procedure is effective on the date of its publication in the Internal Revenue Bulletin. The IRS may conclude agreements under this revenue procedure at any time after that date, but such agreements will not have effect before the date specified in the agreement.

## SECTION 7. PAPERWORK REDUCTION ACT

The collections of information contained in this revenue procedure have been reviewed and approved by the Office of Management and Budget in accordance with the Paperwork Reduction Act (44 U.S.C. 3507) under control number 1545-1597.

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 are contained in sections 4 and 5 of this revenue procedure regarding (1) the application procedures for QI status and withholding agreements, and (2) the provisions of the QI withholding agreement requiring record retention or maintenance, and any communication or contact with the IRS or the account holders. This information will be used to enable the IRS to determine whether to enter into a withholding agreement with the QI applicant and, if accepted, to verify the QI's compliance with the agreement. The collection of information is required to obtain a QI withholding agreement. The likely respondents are business or other for-profit institutions.

The estimated total annual reporting and/or recordkeeping burden is 301,393 hours.

The estimated average annual burden is 30 minutes for a QI account holder, and 2,093 hours for a QI, depending on individual circumstances. The estimated number of respondents and/or recordkeepers is 88,504.

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 8. FURTHER INFORMATION

For further information regarding this revenue procedure, telephone the Office of Assistant Commissioner (International) at (202) 874-1800 (not a toll-free number).

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*26 CFR 601.204: Changes in accounting periods and in methods of accounting.  
(Also Part I, Sections 471; 1.471-2.)*

Rev. Proc. 98-29

## SECTION 1. PURPOSE

This revenue procedure provides guidance for a taxpayer that wants to change to a method of accounting for estimating inventory "shrinkage" in computing ending inventory. "Shrinkage" refers collectively to such items as undetected theft,

breakage, and bookkeeping errors. In addition, section 4 of this revenue procedure provides interim guidance that describes the "retail safe harbor method" for a taxpayer that wants to change to the retail safe harbor method for estimating inventory shrinkage. The procedures for a taxpayer within the scope of this revenue procedure to automatically change to a method of accounting for estimating inventory shrinkage are provided in Rev. Proc. 97-37, 1997-33 I.R.B. 18, as modified by section 5.02 of this revenue procedure. This revenue procedure also requests comments on issues that should be addressed in forthcoming regulations under § 471 regarding proper methods of estimating inventory shrinkage for taxable years ending after August 5, 1997.

## SECTION 2. BACKGROUND

.01 Section 471(a) of the Internal Revenue Code provides that whenever, in the opinion of the Secretary, the use of inventories is necessary in order to clearly determine the income of any taxpayer, inventories must be taken by such taxpayer on such basis as the Secretary may prescribe as conforming as nearly as may be to the best accounting practice in the trade or business and as most clearly reflecting income.

.02 Section 1.471-2(d) of the Income Tax Regulations provides that when a taxpayer maintains book inventories in accordance with a sound accounting system, the net value of the inventory will be deemed to be the cost basis of the inventory, provided that such book inventories are verified by physical inventories at reasonable intervals and adjusted to conform therewith. Physical inventories are used to determine and adjust book inventories for shrinkage.

.03 Section 961 of the Taxpayer Relief Act of 1997 (Act) amended § 471(b) to permit, under certain circumstances, adjustments to ending inventory for estimates of inventory shrinkage. Section 961(b) of the Act provides that, in the case of any taxpayer permitted by § 471(b) to change its method of accounting to a permissible method for any taxable year, the change is treated as made with the consent of the Secretary and the period for taking into account the adjustments under § 481 by reason of such change is four years.

.04 The legislative history (Conference Report and House Report) accompanying the Act provides that a taxpayer is permitted by § 471(b) to change its method of accounting if the taxpayer is currently using a method that does not utilize estimates of inventory shrinkage and wants to change to a method that includes inventory shrinkage estimates based on physical inventories taken at other than year-end. H.R. Rep. No. 220 (Conference Report), 105th Cong., 1st Sess. 466, at 467–68 (1997); H.R. Rep. No. 2014 (House Report), 105th Cong., 1st Sess. 408, at 410 (1997). In addition, the Conference Report provides a safe harbor method applicable to taxpayers primarily engaged in retail trade (the “retail safe harbor method”). The Conference Report further provides that the conferees expect that the Secretary will provide procedures allowing a taxpayer to automatically change to the retail safe harbor method. Pursuant to the Conference Report, use of the retail safe harbor method will be deemed to result in a clear reflection of income, provided such safe harbor method is consistently applied and the taxpayer’s inventory methods otherwise satisfy the clear reflection of income standard.

### SECTION 3. SCOPE

.01 *Applicability.* This revenue procedure applies to a taxpayer requesting the Commissioner’s consent to change to a method of accounting for estimating inventory shrinkage in computing ending inventory, using:

(1) the retail safe harbor method, regardless of whether the taxpayer’s present method of accounting estimates inventory shrinkage; or

(2) a method other than the retail safe harbor method, provided (a) the taxpayer’s present method of accounting does not estimate inventory shrinkage, and (b) the taxpayer’s new method of accounting (that estimates inventory shrinkage) clearly reflects income under § 446(b).

.02 *Inapplicability.* This revenue procedure does not apply to a taxpayer requesting to change to a method other than the retail safe harbor method of accounting for estimating inventory shrinkage in computing ending inventory, if the taxpayer’s present method of accounting estimates inventory shrinkage. A taxpayer requesting such a change must file a Form

3115, Application for Change in Accounting Method, with the Commissioner in accordance with the requirements of § 1.446–1(e)(3)(i) and Rev. Proc. 97–27, 1997–21 I.R.B. 10.

### SECTION 4. RETAIL SAFE HARBOR METHOD

.01 The retail safe harbor method of estimating inventory shrinkage, as described in sections 4.02 through 4.07 of this revenue procedure, may be used in computing ending store inventory by taxpayers that are primarily engaged in retail trade (the resale of personal property to the general public), where physical inventories are normally taken at each location at least annually.

.02 The retail safe harbor method uses a historical ratio of shrinkage to sales to estimate the inventory shrinkage that occurred between the date of the last physical inventory and the end of the taxable year. This historical ratio is based on the actual shrinkage established by all physical inventories taken during the most recent three taxable years and the sales for related periods. The most recent three taxable years include the taxable year for which the shrinkage estimate is to be made and the two prior taxable years. The historical ratio, or estimated shrinkage determined using the historical ratio, cannot be adjusted by judgmental or other factors (for example, floors or caps).

.03 For stores with departments, a taxpayer must determine the historical ratio separately for each store or each department in a store. This determination must be done in the same manner for all stores with departments that are in the same trade or business of the taxpayer. For stores without departments, a taxpayer must determine the historical ratio separately for each store. If a taxpayer has a new store (or a new department in a store) for which the taxpayer has not verified shrinkage by a physical inventory in each of the most recent three taxable years, the historical ratio is the average of the historical ratios of the taxpayer’s other stores (or other departments in the store where the taxpayer computes the historical ratio on a department basis) during the most recent three taxable years.

.04 The estimated inventory shrinkage permitted by the retail safe harbor method is determined by multiplying the histori-

cal ratio for each store or each department in a store by its sales for the period between the date of the last physical inventory and the end of the taxable year.

.05 Taxpayers using the last-in first-out (LIFO) inventory method must allocate shrinkage among their various LIFO inventory pools in a reasonable and consistent manner.

.06 Estimated shrinkage determined in accordance with consistent application of the retail safe harbor method may not be recalculated, through a look-back adjustment or otherwise, to reflect the results of physical inventories taken after year-end.

.07 A taxpayer that changes to the retail safe harbor method must use the retail safe harbor method consistently to determine the ending inventory for all stores that comprise a separate trade or business of the taxpayer. Use of the retail safe harbor method for estimating inventory shrinkage results in the clear reflection of income, provided this method is used consistently and the taxpayer’s inventory methods otherwise satisfy the clear reflection of income standard.

### SECTION 5. CHANGING TO THE RETAIL SAFE HARBOR METHOD OR OTHER METHOD OF ESTIMATING INVENTORY SHRINKAGE

.01 *In general.* Any change in a taxpayer’s computation of ending inventory to estimate inventory shrinkage, or any change in the computation of such estimate, is a change in method of accounting to which the provisions of §§ 446 and 481 and the regulations thereunder apply.

.02 *Automatic change.* A taxpayer within the scope of this revenue procedure that wants to change to a method of accounting for estimating inventory shrinkage in computing ending inventory must follow the automatic change in accounting method provisions of Rev. Proc. 97–37, with the following modifications:

(1) The scope limitations in section 4.02 of Rev. Proc. 97–37, as well as the application procedures in sections 6.03, 6.04, and 6.05 of Rev. Proc. 97–37, do not apply. However, if the taxpayer is under examination, before an appeals office, or before a federal court with respect to any income tax issue, the taxpayer must provide a copy of the Form 3115 to the examining agent(s), appeals officer, or counsel for the government, as appropri-

ate, at the same time that it files the copy of the Form 3115 with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent(s), appeals officer, or counsel for the government, as appropriate.

(2) A taxpayer that, on or before June 12, 1998, files its original federal income tax return for its first taxable year ending on or after August 5, 1997, is not subject to the filing requirement in section 6.02(2)(a) of Rev. Proc. 97-37, provided the taxpayer complies with the following filing requirement. The taxpayer must complete and file a Form 3115 in duplicate. The original must be attached to the taxpayer's amended federal income tax return for the taxpayer's first taxable year ending on or after August 5, 1997. This amended return must be filed no later than August 11, 1998. A copy of the Form 3115 must be filed with the national office (see section 6.02(6) of Rev. Proc. 97-37 for the address) no later than when the taxpayer's amended return is filed.

(3) A taxpayer, whose present method of accounting estimates inventory shrinkage, does not receive audit protection under section 7 of Rev. Proc. 97-37 in connection with a change to the retail safe harbor method if, on the date the taxpayer files a copy of the Form 3115 with the national office, the taxpayer's present method of estimating inventory shrinkage is an issue under consideration within the meaning of section 3.09 of Rev. Proc. 97-37.

(4) In addition to all the requirements and procedures in Rev. Proc. 97-37, as modified by this revenue procedure, the following rules apply to a taxpayer within the scope of this revenue procedure that changes to a method other than the retail safe harbor method of accounting for estimating inventory shrinkage. The taxpayer must provide a detailed description of all aspects of the new method of estimating inventory shrinkage (including, for LIFO

taxpayers, the method of determining inventory shrinkage for, or allocating inventory shrinkage to, each LIFO pool) in the Form 3115 filed by the taxpayer for such a change. The District Director or national office subsequently may review whether the new method clearly reflects the taxpayer's income under § 446(b). If the District Director or the national office determines that the new method of accounting does not clearly reflect the taxpayer's income, the taxpayer will be treated as having made a change in method of accounting without obtaining the consent of the Commissioner as required by § 446(e). See section 6.06 of Rev. Proc. 97-37.

(5) For a change in method of accounting within the scope of this revenue procedure, the provisions of Rev. Proc. 97-37 are effective for taxable years ending after August 5, 1997.

(6) The transition rules in section 13.02 of Rev. Proc. 97-37 do not apply to any change in method of accounting within the scope of this revenue procedure. The Service will return any Form 3115 if it is filed with the national office pursuant to the Code, regulations, or administrative guidance other than Rev. Proc. 97-37 and the change in method of accounting is within the scope of this revenue procedure.

.03 *Future change.* A taxpayer that changes to the retail safe harbor method described in this revenue procedure will not be precluded, solely by reason of such change, from changing to another safe harbor method for estimating inventory shrinkage in computing ending inventory in the first year that such other safe harbor method is available.

#### SECTION 6. REGULATIONS AND REQUEST FOR PUBLIC COMMENT

The Service intends to issue regulations under § 471 regarding proper methods for estimating inventory shrinkage in com-

puting ending inventory for taxable years ending after August 5, 1997. Comments are requested regarding safe harbor methods for estimating inventory shrinkage (including the retail safe harbor method), and any other issues that these regulations should address. Written comments should be submitted by August 11, 1998, to: Internal Revenue Service, P.O. Box 7604, Ben Franklin Station, Washington, DC 20044, Attn: CC:DOM:CORP:R (IT&A BRANCH 7, Room 5226). Submissions may be hand-delivered between the hours of 8 a.m. and 5 p.m. to: Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington DC, Attn: CC:DOM:CORP:R (IT&A Branch 7, Room 5226). Alternatively, taxpayers may submit comments electronically at

[http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html)

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

#### SECTION 7. EFFECTIVE DATE

This revenue procedure is effective for taxable years ending after August 5, 1997.

#### SECTION 8. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 97-37 is modified and amplified to include this automatic accounting method change in the Appendix.

#### DRAFTING INFORMATION

The principal author of this revenue procedure is Jan L. Skelton of the Office of Assistant Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Skelton at (202) 622-4970 (not a toll-free call).



## Part IV. Items of General Interest

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

#### Source and Grouping Rules for Foreign Sales Corporation Transfer Pricing

REG-102144-98

AGENCY: Internal Revenue Service (IRS), Treasury.

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

SUMMARY: In T.D. 8764, page 9 of this Bulletin, the IRS is issuing temporary regulations that provide guidance to taxpayers who have made an election to be treated as a foreign sales corporation (FSC). The regulations provide rules clarifying the special sourcing rules under section 927(e)(1) and provide a deadline for the election to group transactions. This document also provides notice of a public hearing on these proposed regulations. The text of the temporary regulations also serves as the text of the proposed regulations.

DATES: Written comments must be received by June 1, 1998. Requests to speak (with outlines of oral comments) to be discussed at the public hearing scheduled for June 24, 1998, at 10 a.m., must be received by June 3, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-102144-98), room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-102144-98), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option on the IRS Home Page, or by submitting comments directly to the IRS Internet site at [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in Room 2615, Internal Revenue Service, 1111

Constitution Avenue, NW., Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Elizabeth Beck (202) 622-3880; concerning submissions and the hearing, Michael Slaughter, (202) 622-7190 (not toll-free numbers).

#### SUPPLEMENTARY INFORMATION:

##### *Background*

Temporary regulations in T.D. 8764 amend the Income Tax Regulations (26 CFR part 1) relating to sections 925 and 927. The temporary regulations contain rules relating to the grouping of transactions under the FSC transfer pricing rules and the special source rules under section 927(e)(1). The preamble to the temporary regulations explains the temporary regulations.

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

##### *Comments and Public Hearing*

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

A public hearing has been scheduled for June 24, 1998, at 10 a.m., in room 2615, Internal Revenue Building, 1111

Constitution Avenue, NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the Internal Revenue lobby more than 15 minutes before the hearing starts.

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

Persons that wish to present oral comments at the hearing must submit written comments by June 1, 1998, and submit an outline of the topics to be discussed and the time to be devoted to each topic (preferably a signed original and eight (8) copies) by June 3, 1998.

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

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

##### *Drafting Information*

The principal author of the proposed regulations is Elizabeth Beck, of the Office of the Associate Chief Counsel (International). Other personnel from the IRS and Treasury Department also participated in the development of these regulations.

\* \* \* \* \*

##### *Proposed Amendments to the Regulations*

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

#### PART 1—INCOME TAXES

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

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

Section 1.925(a)-1 is also issued under 26 U.S.C. 925(b)(1) and (2) and 927(d)(2)(B).

Section 1.925(b)-1 is also issued under 26 U.S.C. 925(b)(1) and (2) and 927(d)(2)(B). \* \* \*

Par. 2. Section 1.925(a)-1 is added as follows:

[The text of proposed §1.925(a)-1 consisting of paragraphs (c)(8)(i) and (e)(4) is the same as the text of §1.925(a)-1T(c)-(8)(i) and (e)(4) as amended in T.D. 8764.]

Par. 3. Section 1.925(b)-1 is added as follows:

[The text of proposed §1.925(b)-1 consisting of paragraph (b)(3)(i) is the same as the text of §1.925(b)-1T(b)(3)(i) as amended in T.D. 8764.]

Par. 4. Section 1.927(e)-1 is amended as follows:

[The text of proposed §1.927(e)-1 is the same as the text of §1.927(e)-1T published in T.D. 8764.]

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

(Filed by the Office of the Federal Register on March 2, 1998, 8:45 a.m., and published in the issue of the Federal Register for March 3, 1998, 63 F.R. 10351)

## Notice of Proposed Rulemaking and Notice of Public Hearing

### Return of Partnership Income

REG-209322-82

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Withdrawal of notice of proposed rulemaking; notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document withdraws the notice of proposed rulemaking relating to partnership returns. The proposed regulations were published in the **Federal Register** on January 23, 1986 [LR-198-82, 1986-1 C.B. 778]. These regulations revise the partnership filing requirement to reflect changes to the law made by the Taxpayer Relief Act of 1997 (TRA). All partnerships required to file partnership returns, including certain foreign partnerships, are affected by these regulations. This document also contains a notice of a public hearing on the proposed regulations.

DATES: Written comments must be received by April 27, 1998. Requests to speak and outlines of oral comments to be discussed at the public hearing scheduled for May 19, 1998, at 10 a.m., must be received by April 28, 1998.

ADDRESSES: Send submissions to: CC:DOM:CORP:R (REG-209322-82),

room 5226, Internal Revenue Service, POB 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand delivered between the hours of 8 a.m. and 5 p.m. to: CC:DOM:CORP:R (REG-209322-82), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue NW, Washington, DC. Alternatively, taxpayers may submit comments electronically via the Internet by selecting the "Tax Regs" option of the IRS Home Page, or by submitting comments directly to the IRS Internet site at: [http://www.irs.ustreas.gov/prod/tax\\_regs/comments.html](http://www.irs.ustreas.gov/prod/tax_regs/comments.html). The public hearing will be held in the IRS Auditorium, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the regulations, Martin Schäffer or Christopher Kelley, 202-622-3080; concerning foreign partnerships, Ronald Gootzeit, 202-622-3860; concerning submissions and the hearing, Michael Slaughter, 202-622-7190 (not toll-free numbers).

### SUPPLEMENTARY INFORMATION:

#### *Paperwork Reduction Act*

The collection of information contained in this notice of proposed rulemaking has been submitted to the Office of Management and Budget for review in accordance with the Paperwork Reduction Act of 1995 (44 U.S.C. 3507(d)). Comments on the collection of information should be sent to the **Office of Management and Budget**, Attn: Desk Officer for the Department of the Treasury, Office of Information and Regulatory Affairs, Washington, DC 20503, with copies to the **Internal Revenue Service**, Attn: IRS Reports Clearance Officer, T:FP, Washington, DC 20224. Comments on the collection of information must be received by March 27, 1998. Comments are specifically requested on:

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

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

How the quality, utility, and clarity of

the information to be collected may be enhanced;

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

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

The collection of information in this proposed regulation is in §1.6031(a)-1. This information is required to enable the IRS to verify that a taxpayer is reporting the correct amount of income or gain or claiming the correct amount of losses, deductions, or credits from that taxpayer's interest in the partnership. The collection of information is mandatory. The likely respondents are businesses and other for-profit institutions.

The burden is reflected in the burden of Form 1065.

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

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

#### *Background*

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 6031 and 6063 of the Internal Revenue Code of 1986 (Code). These amendments are designed, in part, to reflect changes made to section 6031 by section 1141 of TRA, Public Law 105-34, 111 Stat. 788 (1997). Section 6031 contains rules regarding the filing of returns of partnership income (partnership returns).

On January 23, 1986, the IRS published in the **Federal Register** (51 F.R. 3075) proposed regulations under section 6031 of the Internal Revenue Code (existing proposed regulations). Section 1.6031-1 of the existing proposed regulations provides rules that, if finalized,

would implement the partnership filing requirements of section 404 of the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Public Law 97-248, 96 Stat. 669 (1982). Because section 1141 of TRA supersedes the partnership filing requirements of section 404 of TEFRA, the IRS and Treasury consider it appropriate to reissue proposed regulations reflecting recent changes to the law, while giving taxpayers another opportunity to comment. Accordingly, this document withdraws §1.6031-1 of the existing proposed regulations published in the **Federal Register** on January 23, 1986 (51 F.R. 3075). A partnership that has followed the rules contained in §1.6031-1 of the existing final regulations for all taxable years prior to the taxable year for which these new regulations will become effective will be treated as fully complying with the partnership filing requirements with respect to such taxable years.

Section 6063 provides that a partnership return shall be signed by any one of the partners. The proposed regulations clarify who must sign a partnership return filed solely for the purpose of making certain partnership-level elections.

#### *Explanation of Provisions*

##### *Filing Requirement*

Section 6031(a) requires every partnership to file a partnership return. New section 6031(e), as added by section 1141 of TRA, exempts certain foreign partnerships from the filing requirement of section 6031(a). Section 6031(e) provides that a foreign partnership is not required to file a return for a tax year unless during that year it derives gross income from sources within the United States or has gross income that is effectively connected with the conduct of a trade or business within the United States. Further exceptions to the filing requirement for foreign partnerships may be provided by regulations.

The proposed regulations separately describe the filing requirements for domestic and foreign partnerships. In accordance with section 6031(a), the proposed regulations provide that, except in certain limited circumstances, every domestic partnership must file a partnership return.

Under section 6031 and the proposed regulations, a foreign partnership gener-

ally must file a partnership return only if it has either United States source income or income effectively connected (or treated as effectively connected) with the conduct of a trade or business within the United States. However, under the proposed regulations, a foreign partnership that has no gross income that is effectively connected with the conduct of a trade or business within the United States, and that would be required to file a partnership return only because it has gross income derived from sources within the United States, will be exempt from the requirement to file a partnership return if (i) no United States person has a direct or indirect interest in the partnership; (ii) the gross income derived from sources within the United States is either fixed or determinable annual or periodical income described in §1.1441-2(b) or other amounts subject to withholding described in §1.1441-2(c); (iii) Forms 1042 and 1042-S are filed with respect to all such gross income in accordance with §1.1461-1(b) and (c); and (iv) the tax liability of the partners with respect to such gross income has been fully satisfied by the withholding of tax at the source, if applicable, under chapter 3. The foreign partnership's obligation to file Forms 1042 and 1042-S is generally eliminated by the regulations under section 1461 published in the **Federal Register** on October 14, 1997 (62 F.R. 53387) if those returns are filed by the withholding agent (or agents) making the payments of United States source income to the partnership and the partners' tax liability with respect to United States source income has been fully satisfied by withholding. See §1.1461-1(b)(2) and (c)(4). The IRS and Treasury invite comments addressing other ways to reduce duplicative information filing.

Any domestic or foreign partnership that elects to be excluded from subchapter K of Chapter 1 of the Code under section 761(a) will not be required to file a partnership return, except that where a partnership makes an election under §1.761-2(b)(2)(i), the partnership must timely file a partnership return that contains the information required by §1.761-2(b)(2)(i) for the taxable year for which the election is made.

##### *Failure to Meet Filing Requirement*

If a partnership that is not a small partnership under section 6231(a)(1)(B) is re-

quired to file a partnership return under section 6031 but fails to do so, the period of limitations on assessment of tax attributable to items of that partnership remains open indefinitely under section 6229(a). The failure of a partnership to file a return required by section 6031 might also result in disallowance under section 6231(f) of the deductions, losses, and credits flowing through to the partners and could subject the partnership to penalties under section 6698 and/or section 7203.

##### *Information To Be Furnished to Partners*

Under section 6031(b), every partnership that is required by section 6031(a) to file a partnership return must furnish information to its partners as required by regulations. The rules governing partnership statements to partners and nominees are in §1.6031(b)-1T.

##### *Partnership Elections*

A foreign partnership otherwise exempt from the filing requirement that wants to make a partnership-level election under section 703(b) must file a partnership return for the year of the election. The proposed regulations provide rules similar to those contained in §1.7701-3(c)(2) of the entity classification regulations with respect to who has the authority to file such returns. Generally, the return must be signed by all partners or by an authorized partner.

##### *Proposed Effective Dates*

These regulations are proposed to be applicable to partnership tax years ending on or after the 90th day after final regulations on this subject are published in the **Federal Register**. However, the exceptions for certain foreign partnerships contained in §1.6031(a)-1(b)(2) will not be applicable to any partnership taxable years beginning before January 1, 1999.

##### *Special Analyses*

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in EO 12866. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to these proposed regulations. It is hereby certified

that the collection of information contained in these proposed regulations will not have a significant economic impact on a substantial number of small entities. This certification is based on the fact that the regulations would reduce (rather than increase) the number of small entities that are required to file a partnership return. Specifically, the proposed regulations would eliminate the filing requirements for certain foreign partnerships that are fully subject to withholding in order to prevent duplicative filing requirements. In addition to eliminating the filing requirements in these circumstances, for ease of reference the proposed regulations update and restate the general requirements to file a partnership return as set forth in existing regulations. Because the proposed regulations would not impose any new reporting requirements that are not imposed by the existing regulations, and the only significant modification of the existing regulations is to eliminate the filing requirement for certain foreign partnerships, the regulations will not have a significant economic impact on a substantial number of small entities. Accordingly, a Regulatory Flexibility Analysis under the Regulatory Flexibility Act (5 U.S.C. chapter 6) is not required. Pursuant to section 7805(f) of the Code, these proposed regulations will be submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on their impact on small business.

#### Comments and Public Hearing

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

A public hearing has been scheduled for Tuesday, May 19, 1998, at 10 a.m., in the IRS Auditorium, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue NW, Washington, DC. Because of access restrictions, visitors will not be admitted beyond the building lobby more than 15 minutes before the hearing starts.

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

Persons that wish to present oral comments at the hearing must submit written comments by April 27, 1998, and submit

an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by April 28, 1998.

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

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

#### Drafting Information

The principal authors of these regulations are Martin Schäffer and Christopher Kelley, Office of Assistant Chief Counsel (Passthroughs and Special Industries), and Ronald Gootzeit, Office of the Associate Chief Counsel (International). However, other personnel from the IRS and Treasury Department participated in their development.

\* \* \* \* \*

#### Withdrawal of Proposed Amendments to the Regulations

Accordingly, under the authority of 26 U.S.C. 7805, the notice of proposed rulemaking that was published in the **Federal Register** on January 23, 1986 (51 F.R. 3075) is withdrawn.

#### 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 is amended by adding an entry in numerical order to read as follows:

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

Section 1.6031(a)-1 also issued under 26 U.S.C. 6031. \* \* \*

#### **§1.6031-1 [Removed]**

Par. 1a. Section 1.6031-1 is removed.

Par. 2. Section 1.6031(a)-1 is added to read as follows:

#### *§1.6031(a)-1 Return of partnership income.*

(a) *Domestic partnerships*—(1) *Return required.* Except as provided in paragraphs (a)(3) and (c) of this section, every domestic organization that is a partner-

ship must file a return of partnership income under section 6031 (partnership return) for each taxable year on the form prescribed for the partnership return. The partnership return must be filed for the taxable year of the partnership regardless of the taxable years of the partners. For taxable years of a partnership and of a partner, see section 706 and §1.706-1. For the rules governing partnership statements to partners and nominees, see §1.6031(b)-1T.

(2) *Content of return.* The partnership return must contain the information required by the prescribed form and the accompanying instructions.

(3) *Special rule.* A partnership that has no income, deductions, or credits for federal income tax purposes for a taxable year is not required to file a partnership return for that year.

(4) *Failure to file.* For the consequences of a failure to comply with the requirements of section 6031(a) and this paragraph (a), see sections 6229(a), 6231(f), 6698, and 7203.

(b) *Foreign partnerships*—(1) *Return required.* A foreign partnership must file a partnership return for a partnership taxable year only if it has gross income derived from sources within the United States or it has gross income that is (or is treated as) effectively connected with the conduct of a trade or business within the United States for the taxable year. Certain exceptions to this requirement are provided in paragraphs (b)(2) and (c) of this section. A foreign partnership that is required to file a partnership return must file the partnership return in accordance with the rules provided for domestic partnerships in paragraph (a) of this section.

(2) *Exception to partnership return requirement for certain foreign partnerships investing in the United States.* A foreign partnership that has no gross income that is effectively connected with the conduct of a trade or business within the United States, and that would be required to file a partnership return only because it has gross income derived from sources within the United States, is not required to file a partnership return under section 6031 if—

(i) No United States person has a direct or indirect interest in the partnership;

(ii) The gross income derived from sources within the United States is either

fixed or determinable annual or periodical income described in §1.1441-2(b) or other amounts subject to withholding described in §1.1441-2(c);

(iii) Forms 1042 and 1042-S are filed with respect to all such gross income in accordance with §1.1461-1(b) and (c). In order to satisfy this requirement, Forms 1042 and 1042-S must be filed by the partnership unless the partnership is not required to file such returns under §1.1461-1(b)(2) and (c)(4), in which case, Forms 1042 and 1042-S must be filed by another withholding agent (or agents); and

(iv) The tax liability of the partners with respect to such gross income has been fully satisfied by the withholding of tax at the source, if applicable, under chapter 3 of the Internal Revenue Code.

(3) *Partnership information or returns required of partners who are United States persons*—(i) *In general*. If a United States person is a partner in a partnership that is not required to file a partnership return, the district director or director of the service center may require that person to render the statements or provide the information necessary to verify the accuracy of the reporting by that person of any items of partnership income, gain, loss, deduction, or credit.

(ii) *Certain partnership elections*. For a partnership that is not otherwise required to file a partnership return, if an election that can only be made by the partnership under section 703 (affecting the computation of taxable income derived from a partnership) is to be made by or for the partnership, a return on the form prescribed for the partnership return must be filed for the partnership. The return must be signed by—

(A) Each partner that is a partner in the partnership at the time the election is made; or

(B) Any partner of the partnership who is authorized (under local law or the partnership's organizational documents) to make the election and who represents to having such authorization under penalties of perjury.

(iii) *Controlled foreign partnerships*. Certain United States persons who are partners in a foreign partnership controlled (within the meaning of section 6038(e)(1)) by United States persons may be required to provide information with

respect to the partnership under section 6038.

(4) *Exclusion for certain organizations*. The return requirement of section 6031 and this section does not apply to the International Telecommunications Satellite Organization, the International Maritime Satellite Organization, or any organization that is a successor of either.

(c) *Partnerships excluded from the application of subchapter K*—(1) *Wholly excluded*—(i) *Year of election*. An eligible partnership as described in §1.761-2(a) that elects to be excluded from all the provisions of subchapter K of chapter 1 of the Internal Revenue Code in the manner specified by §1.761-2(b)(2)(i) must timely file the form prescribed for the partnership return for the taxable year for which the election is made. In lieu of the information otherwise required, the return must contain or be accompanied by the information required by §1.761-2(b)(2)(i).

(ii) *Subsequent years*. Except as otherwise provided in paragraph (c)(1)(i) of this section, an eligible partnership that elects to be wholly excluded from the application of subchapter K is not required to file a partnership return.

(2) *Deemed excluded*. An eligible partnership that is deemed to have elected exclusion from the application of subchapter K beginning with its first taxable year, as specified in §1.761-2(b)(2)(ii), is not required to file a partnership return.

(d) *Definitions*—(1) *Partnership*. For the meaning of the term *partnership*, see §1.761-1(a).

(2) *United States person*. In applying this section, *United States person* means a person described in section 7701(a)(30); the government of the United States, a State, or the District of Columbia (including an agency or instrumentality thereof); or a corporation created or organized in Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, and American Samoa, if the requirements of sections 881(b)(1)(A), (B), and (C) are met for such corporation. The term does not include an alien individual who is a resident of Puerto Rico, Guam, the Commonwealth of Northern Mariana Islands, the U.S. Virgin Islands, or American Samoa, as determined under §301.7701(b)-1(d) of this chapter.

(e) *Procedural requirements*—(1) *Place for filing*—(i) *Domestic partner-*

*ships*. The return of a domestic partnership that is required to file under paragraph (a) of this section must be filed with the service center for the internal revenue district in which the partnership has its principal office or principal place of business in the United States.

(ii) *Foreign partnerships with United States business or income*. The return of a foreign partnership that is required to file under paragraph (b)(1) of this section must be filed—

(A) With the service center for the internal revenue district in which the partnership has its principal office or principal place of business in the United States; or

(B) With the Internal Revenue Service Center, Philadelphia, PA 19255-0011 if the partnership has no office or place of business in the United States.

(iii) *Foreign partnerships without United States business or income*. The return of a foreign partnership filed under paragraph (b)(3)(ii) of this section (regarding partnerships for which an election under section 703 is made) must be filed with the Internal Revenue Service Center, Philadelphia, PA 19255-0011. A statement must be attached to the partnership return indicating that the return is being filed pursuant to paragraph (b)(3)(ii) of this section solely to make one or more elections under section 703.

(2) *Time for filing*. The return of a partnership must be filed on or before the fifteenth day of the fourth month following the close of the taxable year of the partnership.

(3) *Magnetic media filing*. For magnetic media filing requirements with respect to partnerships, see section 6011(e)(2) and the regulations thereunder.

(f) *Effective date*. This section applies to taxable years of a partnership ending on or after the 90th day after the date final regulations on this subject are published in the **Federal Register**. However, in no event will paragraph (b)(2) of this section apply to taxable years of a partnership that begin before January 1, 1999.

Par. 3. Section 1.6063-1 is amended by adding paragraph (c) to read as follows:

*§1.6063-1 Signing of returns, statements, and other documents made by partnerships.*

\* \* \* \* \*

(c) *Certain partnership elections*—(1) *In general.* For rules regarding the authority of a partner to sign a partnership return filed solely for the purpose of making certain partnership-level elections, see §1.6031(a)-1(b)(3)(ii).

(2) *Effective date.* The provisions of paragraph (c) of this section apply for taxable years of a partnership ending on or after the 90th day after the date final regulations on this subject are published in the **Federal Register**.

Michael P. Dolan,  
Deputy Commissioner of  
Internal Revenue.

(Filed by the Office of the Federal Register on January 23, 1998, 8:45 a.m., and published in the issue of the Federal Register for January 26, 1998, 63 F.R. 3677)

## The IRS Will Permit Electronic Submission of Forms W-9 and W-9S

### Announcement 98-27

#### Form W-9

The Internal Revenue Service will allow payers to establish a system to electronically receive Forms W-9, Request for Taxpayer Identification Number and Certification. In general, the electronic system must meet the requirements described in paragraphs (1) through (5) below. However, for Forms W-9 that are not required to be signed, the electronic system need not meet the requirements described in paragraph (3). The IRS will revise the "Instructions for the Requester of Form W-9" to reflect the provisions of this announcement.

For purposes of this announcement, "payer" refers to a person required to file an information return. "Payee" refers to the person required to submit Form W-9 to the payer.

#### Form W-9S

The Internal Revenue Service will also allow educational and lending institutions to establish a system for students and borrowers to electronically submit Form W-9S, Request for Student's or Borrower's Social Security Number and Certification. The IRS will revise the instructions for Form W-9S to reflect the

provisions of this announcement. In general, the electronic system must meet the requirements described in paragraphs (1), (2), (4), and (5) below. Further, if an electronic Form W-9S is used to certify that the borrower will use the loan proceeds to pay for qualified higher education expenses, the lending institution's electronic system must also meet the requirements described in paragraph (3)(A) below.

#### Requirements

(1) *In general.* The electronic system must ensure that the information received by the payer or educational or lending institution is the information sent by the payee, student, or borrower. The system must document all occasions of user access that result in the submission. In addition, the design and operation of the electronic system, including access procedures, must make it reasonably certain that the person accessing the system and submitting the Form W-9 or W-9S is the person identified in the form.

(2) *Same information as paper Form W-9 or W-9S.* The electronic submission must provide the payer or educational or lending institution with exactly the same information as the paper Form W-9 or W-9S.

(3) *Signature requirements and perjury statement.* The electronic submission must be signed with an electronic signature by the payee whose name is on the Form W-9 or by the borrower whose name is on the Form W-9S.

(A) *Electronic signature.* The electronic signature must identify the payee or borrower submitting the electronic form and must authenticate and verify the submission. For this purpose, the terms "authenticate" and "verify" have the same meanings as they do when applied to a written signature on a paper Form W-9 or W-9S. An electronic signature can be in any form that satisfies the foregoing requirements. The electronic signature must be the final entry in the submission.

(B) *Perjury statement.* The electronic signature on Form W-9 must be under penalties of perjury. The perjury statement must contain the language that appears on the paper Form W-9. The electronic system must inform the payee that he or she makes the declaration contained in the perjury statement and that the declaration is made by signing the

Form W-9. The instructions and the language of the perjury statement must immediately follow the payee's certifying statements and immediately precede the electronic signature.

(4) *Copies of electronic Forms W-9 or W-9S.* Upon request by the Internal Revenue Service, the payer or educational or lending institution must supply a hard copy of the electronic Form W-9 or W-9S and a statement that, to the best of the payer's or educational or lending institution's knowledge, the electronic Form W-9 or W-9S was submitted by the named payee, student, or borrower. The hard copy of the electronic Form W-9 or W-9S must provide exactly the same information as, but need not be a facsimile of, the paper Form W-9 or W-9S.

(5) *Effective date.* This announcement applies to Forms W-9 and W-9S submitted electronically by payees, students, or borrowers on or after April 13, 1998.

For further information regarding this announcement, contact Donna Welch of the Office of the Assistant Chief Counsel (Income Tax and Accounting) at (202) 622-4910 (not a toll-free call).

## Foundations Status of Certain Organizations

### Announcement 98-28

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

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

Adams House, San Rafael, CA  
Adelaide Hollander Scholarship  
Foundation, Inc., Pomona, NJ

Alliance for a SAFER Greater Detroit, Detroit, MI  
 American Homeowners Resource Center, San Juan Capistrano, CA  
 Bradley Creek Extension Homemakers Club, Wilmington, NC  
 Central Pittsburgh Amateur Hockey Association, Pittsburgh, PA  
 Chautauqua Group, Boulder, CO  
 Chemical People of Charles County Inc., LaPlata, MD  
 Cheniere Hurricane Centennial, Cut Off, LA  
 Cherokee Chief Indian Ministry Inc., Hot Springs, AR  
 Cherokee Strip Centennial Corporation, Perry, OK  
 Chevra Kadisha of Houston Inc., Houston, TX  
 Chicago Black Horse Troop Association Inc., Rockford, IL  
 Chicago Breakthrough Foundation, Chicago, IL  
 Chicago Printing Ink Production Club, Inc., Hickory Hills, IL  
 Chief Frank Fools Crow Memorial Foundation and Humanitarian Fund, Pine Ridge, SD  
 Community Chiropractic Health Clinics of California, Inc., Oroville, CA  
 Delray Beach Community Development Corporation, Delray Beach, FL  
 Delta Axis Inc., Memphis, TN  
 Delta Blues Educational Fund, Clarksdale, MS  
 Deming Youth Center Incorporated, Deming, NM  
 Dendron Volunteer Fire Dept Inc., Dendron, VA  
 Denim & Lace Inc., Lamar, CO  
 Denton Youth Football Association Inc., Denton, TX  
 District of Columbia Comprehensive Aids Resources & Education, Washington, DC  
 Divorce Center Inc., New Orleans, LA  
 Dixie Manor Resident Management, Pinson, AL  
 DMC-Midwives Inc., Detroit, MI  
 DMC-OBGYN Inc., Detroit, MI  
 Economic Services Inc., Madison, FL  
 Ecorse Resident Council, Ecorse, MI  
 Ed U Care Child Development Center Inc., Kansas City, MO  
 Edu-Quest Education Foundation Inc., Virginia Beach, VA  
 Educaring Inc., Tucson, AZ  
 Educate America First Foundation, Littleton, CO  
 Education and Auditory Resource Services, Jackson, MS  
 Education First Foundation Inc., Palm Beach Gardens, FL  
 Edwards County Healthcare Foundation, Kinsley, KS  
 Egg Harbor Township Community Playground, Pleasantville, NJ  
 El Paso Metro Police Activities League Inc., El Paso, TX  
 El Paso Music Teachers Association, El Paso, TX  
 Emporia Basketball Club Inc., Emporia, KS  
 Engine House No. 5 Foundation, Allendale, MI  
 Environmental Concerns Inc., Lafayette, LA  
 Envision Inc., New Orleans, LA  
 Extended Health Care Services Inc., Montclair, NJ  
 Fayette County Crisis Pregnancy Chapter Inc., Fayetteville, GA  
 Federation for Civic Action Incorporated, Milwaukee, WI  
 Feener Family Ministries, Olive Branch, MS  
 Fellowship Christian Center, Omaha, NE  
 Fellowship Foundation, New Orleans, LA  
 Financial Responsibility Advocacy Project, Washington, DC  
 Fire Instructors Association of North Texas Inc., Bedford, TX  
 Fire Museum of Texas Association Inc., Beaumont, TX  
 First Christian Church Early Childhood Development Center, Beckley, WV  
 First Coast Chapter of Tuskegee Airmen Inc., Jacksonville, FL  
 First Impressions, Cleveland, TN  
 First Trees for the World Foundation Inc., Washington, DC  
 Fisher Community Foundation for Educational, Champaign, IL  
 Foster Children of Johnson County Inc., Leawood, KS  
 Foundation for Abused and Neglected Children, Dallas, TX  
 Foundation for Advanced Studies Inc., Coralville, IA  
 Foundation for Allied Conservative Therapies Research, Lawrence, KS  
 Foundation for Homecare Inc., Wilmington, NC  
 Foundation for Nager and Miller Syndromes, Glenview, IL  
 Foundation for Northern Thailand Scholarship, Humble, TX  
 Fund 2000, Gastonia, NC  
 Gordon Junior Sandhills Wrestling Association, Gordon, NE  
 Goshen Community Theatre Inc., Goshen, IN  
 Gospel Light Ministries Inc., Madison, TN  
 Gospel Music Workshop of America New Orleans Chapter, New Orleans, LA  
 Gospel Singers Inc., Dallas, TX  
 Governors Commission on Educational Choice, Akron, OH  
 Grace Emory Foundation Inc., Doraville, GA  
 Grace House Deborah M. Barker, Marion, IN  
 Grace Ministries International, Rochester, MN  
 Grace Pavilion Foundation, Northbrook, IL  
 Grove Outreach Inc., Coconut Grove, FL  
 Guardian Ad Litem Advisory Board of Charlotte County Inc., Punta Gorda, FL  
 Gwinnett County Childrens Association, Inc., Lawrenceville, GA  
 Habersham County Council on Child Abuse Inc., Clarkesville, GA  
 Habilitation Concepts Inc., Fort Worth, TX  
 Haitian Relief V A D I G Inc., Boynton Beach, FL  
 Hamblen Adults Working for Kids Inc., Morristown, TN  
 Hamblen County Recreational Flag Football Association, Russellville, TN  
 Hamblen Museum of Glass and Antiques, Lebanon, TN  
 Hamilton Housing Development Corporation, Cincinnati, OH  
 Hampton Apple Tree Club House Inc., Hampton, VA  
 Hancock County Food Pantry Inc., Bay St. Louis, MS  
 Handicapped Transportation Inc., Oklahoma City, OK  
 Handicapped Veterans Society Inc., North Miami Beach, FL  
 Hands for Humanity Inc., Frenchburg, KY  
 Hands Healing Hearts, Miami, FL  
 Hands on Battle Creek Museum, Battle Creek, MI  
 Hannahs House Inc., Louisville, KY

Hanner Summer Camp Inc.,  
Chattanooga, TN

Happy Birthday Jesus Foundation,  
Bellbrook, OH

Happy Christian Homes Inc., Tempe,  
AZ

Harborside Performers Inc., Punta Gorda,  
FL

Harc IV Housing Inc., Birmingham, AL

Hardcore Evangelistic Ministries Inc.,  
Dallas, TX

Harrah Senior Housing Corporation II,  
Harrah, OK

Harris County Friends of the Library,  
Katy, TX

Harrison County Conservation Society  
Inc., Marshall, TX

Harvard Club of San Antonio, San  
Antonio, TX

Harvest Hands, Grand Blanc, MI

Harvest Homes Inc., Kokomo, IN

Harvey Oilers Booster Club Inc., Harvey,  
LA

Help Inc., Baltimore, MD

H I M Incorporated, Raleigh, NC

H O M E, Washington, DC

H O P E Center Inc., Abilene, KS

House of Prayer Ministries, Efland, NC

House of Prayer Ministry Inc., Gonzalez,  
LA

House of Ruth Inc., Louisville, KY

Institute for Biodynamic Shelter, Inc.,  
Waldoboro, ME

Institute for International Initiatives Inc.,  
Austin, TX

J & M Therapeutic Foster Group Home,  
Houston, TX

J and M Moore Foundation, Duluth, MN

J C Bubb Rudd Foundation Inc.,  
Beaumont, TX

Jacksonville Area Caring for Kids Inc.,  
Jacksonville, FL

Jesus Christ Evangelistic Ministries,  
Delaware, OH

Kairos Center for Spiritual Renewal Inc.,  
Mason, TX

Kakapo Rescue, Salt Lake City, UT

Kalamazoo Alternative Housing Inc.,  
Kalamazoo, MI

Korean American Heritage Foundation,  
Inc., San Francisco, CA

LA Federation of Families, Covington,  
LA

La Maison De Beaux Arts Co., New  
Orleans, LA

Laurinburg Homework Center Inc.,  
Laurinburg, NC

Lawndale Apartments Inc. Non Profit  
Housing Corporation, Mt. Pleasant, MI

Lawrence County Minority Economic  
Trade and Development Association,  
Ironton, OH

Lawrence-Douglas County Coalition for  
the Homeless Inc., Lawrence, KS

Lawton Education Foundation Inc.,  
Mattawan, MI

Laynor Foundation, Scottsdale, AZ

Leann J Hauptman Foundation Inc.,  
Bethesda, MD

Learning Disabilities Association of  
McLennan County, Waco, TX

Learning for Everyone Inc., Americus,  
GA

Lebanon Girls Softball League, Lebanon,  
MO

Ledbetter Community Development  
Corporation, Dallas, TX

L W G Family Ministries Inc., Many, LA

L Y Dean III Foundation Inc., Eufaula, AL

L Y O A Cancer Support Group,  
Houston, TX

M A D Dads of Martin County Inc.,  
Stuart, FL

Mac House Inc., Houston, TX

MacGregor Area Community  
Development Corporation, Houston,  
TX

Macon County Role Model Association,  
Tuskegee, AL

Madison Brown Scholarship Fund Inc.,  
Gibsonville, NC

Madison Community Housing  
Incorporated, London, OH

Madison Curling Foundation Inc.,  
Madison, WI

Madisonville Hopkins County Labor-  
Management Committee, Inc.,  
Madisonville, KY

Magalit, Bedford, TX

Magdalena Youth Athletics Association,  
Magdalena, NM

Maggie Valley Police Association,  
Maggie Valley, NC

Main Street Clarksville Inc., Clarksville,  
TN

Main Street Ozark Inc., Ozark, AR

Make It Live Productions, Chicago, IL

Malinis Dances of India, Ann Arbor, MI

Mallard Bryant Smith Inc., Alliance, OH

Man-Environment Relations Research,  
Chesapeake Beach, MD

Mancelona Area Resource Conservation  
Coalition, Mancelona, MI

Mandalay Community Center Inc.,  
Westminster, CO

Mandt Community Center Inc.,  
Stoughton, WI

Manhattan Marlins Inc., Manhattan, KS

Marathon County Crime Stoppers,  
Weston, WI

Marbled Ball Kids Inc., Houston, TX

Margil House of Studies, Houston, TX

Marin City Childrens Church, San  
Francisco, CA

Marion County Alliance of  
Neighborhood Associations, Inc.,  
Indianapolis, IN

Marion County Community  
Development Corporation, Ocala, FL

Marion County Historical Society, Buena  
Vista, GA

Mark Wanker Ministries Inc., Jackson,  
MS

Marquette Fine Arts Council Inc.,  
Marquette, KS

Marriage Impact Ministries Inc., Phoenix,  
AZ

Mars Mission International, Houston,  
TX

Martha Mary House for Women &  
Children, Berryville, AR

Meadows Healthcare Resources, Inc.,  
Vidalia, GA

Mid-South Transportation Management,  
Memphis, TN

Middle East Medievalists, Northbrooke,  
IL

Middletown Athletic Association,  
Levittown, PA

Midland Area Aids Support Inc.,  
Midland, TX

Midwest Center for Arts, Minneapolis,  
MN

Midwest Civic Council, Detroit, MI

Midwest Regional Space Center, Cedar  
Rapids, IA

Midwest YMCA of America, Chicago, IL

Militant Church of the Fields, Big Horn,  
WY

National Association of Black  
Communications Professionals,  
Columbia, MD

National Association of Planning  
Councils, Oklahoma City, OK

National Association of Resident  
Management Corps, Washington, DC

National Association of Sportsman  
Legislators, Knoxville, TN

National Black Music Caucus,  
Philadelphia, PA



National Center for Mood Disorders,  
Houston, TX  
National Childrens Assistance  
Association, Searcy, AR  
National Church Residences of  
Charleston, WV, Columbus, OH  
National Coalition of 100 Black  
Children, Inc., Jackson, MS  
National Computer Society of the Deaf,  
Woodridge, IL  
The National Dorymens Association,  
Mission Viejo, CA  
Nazareth Communications, Inc.,  
Greenville, SC  
Nellys Puppet Theatre Company,  
Lexington, KY  
North Penn Improvement Association,  
Hatfield, PA  
North Royalton Playground Fund, North  
Royalton, OH

North Woods Fishing Club, Mishawaka,  
IN  
Northeast Denver Learning and Resource  
Center, Inc., Denver, CO  
Northeast Neighborhood House Inc.,  
Washington, DC  
Northern Business Aids Project,  
Woodstock, IL  
Northern New Jersey Christian Life  
Coalition, Inc., Wyckoff, NJ  
Office of Croatian Affairs, South San  
Francisco, CA  
Resident Association Members, Johnson  
City, TN  
San Diego Family Day Care Association,  
Inc., Escondido, CA  
Sash Inc., Glendale, MD  
Seagoville Area Soccer Association,  
Seagoville, TX

Society for Cinephiles-Cinecon, Inc., Los  
Angeles, CA  
Southern Burn Foundation, Inc., Augusta,  
GA  
Visual Pen Pals Inc., Atlanta, GA  
Voices Past Inc., Tulsa, OK

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

## Definition of Terms

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

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

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

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

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

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

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

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

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

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

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

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

## Abbreviations

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

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

E.O.—Executive Order.  
ER—Employer.  
ERISA—Employee Retirement Income Security Act.  
EX—Executor.  
F—Fiduciary.  
FC—Foreign Country.  
FICA—Federal Insurance Contribution Act.  
FISC—Foreign International Sales Company.  
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.—Statements of Procedural Rules.  
Stat.—Statutes at Large.  
T—Target Corporation.  
T.C.—Tax Court.  
T.D.—Treasury Decision.  
TFE—Transferee.  
TFR—Transferor.  
T.I.R.—Technical Information Release.  
TP—Taxpayer.  
TR—Trust.  
TT—Trustee.  
U.S.C.—United States Code.  
X—Corporation.  
Y—Corporation.  
Z—Corporation.

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

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